No. 518

In the Supreme Court of the United States

OCTOBER TERM, 1959

UNITED STATES, PETITIONER

v.

CANNELTON SEWER PIPE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

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BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The District Court wrote no opinion. Its findings of fact and conclusions of law (R. 3–7) are not officially reported. The opinion of the Court of Appeals (R. 266–274) is reported at 268 F. 2d 334.

JURISDICTION

The judgment of the Court of Appeals was entered on June 15, 1959. (R. 275.) By order of Mr. Justice Clark, dated September 10, 1959, the time for petitioning for a writ of certiorari was extended to November 12, 1959. (R. 276.) The petition for a writ of certiorari was filed on November 4, 1959, and was granted on December 14, 1959. (R. 276.) The juris-

diction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Taxpayer, an integrated miner-manufacturer, mines fire clay and shale and, utilizing these minerals, manufactures sewer pipe and other finished products. There is an extensive market for fire clay and shale, but taxpayer does not sell on the mineral market; its mining and transportation costs are high and it would be unprofitable for taxpayer to do so.

Under the Internal Revenue Code, miners of designated minerals are entitled to a depletion allowance determined by applying a specified percentage to the taxpayer's gross income from "mining." "Mining" is defined as including "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products * * *."

The question presented by this case is whether the commercially marketable mineral products, for purposes of determining taxpayer's allowance for mineral depletion, are fire clay and shale (the cut-off point for all non-integrated miners of these minerals) or whether, as held below, taxpayer may include in its gross income from "mining" the proceeds received from sale of sewer pipe and other finished products of its factories.

STATUTE AND REGULATIONS INVOLVED

The pertinent statutory provisions and Treasury Regulations are Sections 23(m) and 114(b)(4) of the Internal Revenue Code of 1939 and Section 29.23(m)-

1(f) of Treasury Regulations 111, printed in Appendix A, *infra*, pp. 92–96.

STATEMENT

Taxpayer, an Indiana corporation, has its principal place of business in southwestern Indiana. (R. 4, 195.) During the taxable year ended November 30, 1951, it was engaged in the mining of fire clay[1] and shale and in manufacturing those minerals (in 60–40 proportions) into vitrified sewer pipe, flue lining, wall coping and filter blocks. (R. 4–5.) During 1951, it mined 38,473 tons of fire clay and shale,[2] of which 60 percent (about 23,084 tons) was fire clay. (R. 5.) It sold no raw fire clay or shale, except for 80 tons of clay and shale sold in ground form for $1,822.45. (R. 4–5.) The remainder was used in manufacturing its finished products, the sales prices of which totalled $1,409,145.66. (R. 5.)

Fire clay and shale are used in the manufacture of a variety of different products. In Indiana, for example, fire clay is used in making refractory brick, pottery, structural tile, farm drain tile, face brick,

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[1] Fire clay, for which depletion is allowed at a 15-percent rate, is to be distinguished from brick and tile clay, for which only a 5-percent rate of depletion is allowed.

[2] The fire clay and shale which taxpayer mines is from a geological formation, generally called the Pennsylvania formation, which, in Indiana, is located in the southwestern part of the State extending northward. The same formation extends into Kentucky directly across the river from Cannelton, Indiana. (R. 30, 40.) The fire clay in the formation is known as Pennsylvania underclay and lies directly beneath a thin layer of coal. (R. 5, 24, 118–119.) The shale, which is also a clay but contains some iron and is darker than fire clay when fired (R. 201–204), lies beneath the underclay (or fire clay).

sewer pipe, flue linings, conduit pipe and insulators. Shale is also used for most of those purposes, as well as in the production of cement and for paving brick and lightweight aggregate. (See Ex. A, R. 209.)

Fire clay and shale are produced and sold in large quantities in their raw form. (R. 270.) Thus, in Indiana, in 1951 (the taxable year), more than 500,000 short tons of fire clay were produced, of which over 300,000 tons were sold and the remainder used by the producers thereof. (R. 271.) The United States production (in 31 states, including Indiana) was 11,852,517 tons, of which more than one-fourth (3,159,667 tons) was sold and the remainder used by the producers thereof in making finished products from it. (See Minerals Yearbook (1951), U.S. Bureau of Mines, Department of the Interior, p. 294; see also, R. 136; Ex. A., R. 207.) Substantial amounts of shale were also produced and sold in Indiana (R. 209), as well as in the United States generally.[3] In 1951, seven Indiana producers of fire clay and two Indiana producers of shale engaged in non-integrated operations, that is, strictly in the extraction of the raw fire clay and shale. (R. 270.)

The District Court held that the taxpayer is entitled to take depletion on the total sales ($1,409,145.66) of its finished manufactured products, such as sewer pipe. (R. 6.) In so holding, it found (Fdg.

[3] The shale statistics for the United States, contained in the Minerals Yearbook, *infra*, p. 300, are included under the heading of "miscellaneous clays," of which 27,649,491 tons were produced. Of that amount, 989,739 tons were sold and the remainder was used by the producers thereof. *Ibid.*

10, R. 5): "All of the processes used and applied by plaintiff to the fire clay and shale which it mined and used, were processes normally applied by mine owners or operators who are engaged in the manufacture of vitrified clay sewer pipe and related products."

The Court of Appeals affirmed. Noting that taxpayer's costs are such that it could not profitably sell raw fire clay and shale, the court concluded that taxpayer has a different commercially marketable product than non-integrated members of the same mining industry and that it may take mineral depletion on the basis of the gross proceeds received from sale of its factory output. (R. 266–274.)

SUMMARY OF ARGUMENT

Introduction

Mineral depletion is an allowance for the exhaustion of wasting assets. *Percentage* depletion is a statutory method for ascribing value to those assets. Under this method, a percentage, specified for each mineral by Congress, is applied to "gross income from the property" (in turn, defined as "gross income from mining"); the resulting figure constitutes the allowance.

The dispute in this case relates to the legal criteria by which a taxpayer is to determine what is embraced in "gross income from mining." The relevant statutory provision (Section 114(b)(4)(B) of the 1939 Code) states that "mining" does not include merely the "extraction of the ore or minerals from the ground," but includes also "the ordinary treatment

processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." The same section furnishes some additional guidance, for it specifically lists, in the case of certain minerals (but not those here involved), processes within or outside the concept of "ordinary treatment processes." For example, a coal miner may include "cleaning, breaking, sizing and loading for shipment." A miner of lead, zinc, copper, gold or silver may include, *inter alia*, so-called concentration processes, but *not* smelting or refining.

In the instant case, the court below has permitted taxpayer, a miner-manufacturer who extracts fire clay and shale and converts them into new finished products, such as sewer pipe, to take as the depletion base the gross receipts from the sale of factory output. The court below explicitly found that other miners in taxpayer's own state made substantial sales of raw fire clay and shale. It rested its holding that this taxpayer might nonetheless compute its depletion by reference to the price of manufactured products on a finding (not challenged by the Government) that taxpayer's mining and transportation costs were so high that it could not profitably market the minerals in crude form (a circumstance, we note, which hardly suggests that its mine has great value).

The consequences of this holding are plain. Narrowly viewed, the effect is that taxpayer gets a depletion allowance of over four dollars a ton, whereas a non-integrated miner of fire clay and shale (minerals which sold in Indiana for less than two dollars a ton) would get a depletion allowance of fifteen or twenty

cents a ton. More broadly, the threat is widespread discrimination and dislocation in the economy; virtually unlimited opportunity for some taxpayers to obtain manufacturing subsidies in the guise of mineral depletion; and grave loss to the federal revenue.

We challenge two fundamental propositions which are at the core of the holding below: (1) that the product with reference to which the gross income from mining is computed varies according to the particular product which the taxpayer, on the basis of his particular operation, finds it profitable to sell; (2) that the phrase "ordinary treatment processes normally applied by mine owners or operators" may be extended to take in processes which could never be employed by one who is strictly a mine operator and can only be utilized by one who is also a manufacturer. In doing so, we rely upon the statutory language and terminology and upon a legislative history of some forty years which we believe to be totally irreconcilable with the approach adopted by the Court of Appeals.

I

The statute shows on its face that Congress has adopted a generic or class description—one which imposes an industry-wide test and precludes the individual taxpayer from including such processes as he may use to obtain the particular product which he markets. The statute permits only the inclusion of *ordinary* treatment processes *normally* applied by mine owners or operators. It is normal, to be sure, for an integrated miner-manufacturer to fabricate

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minerals into new products. But it cannot be ordinary or normal for miners, *qua* miners, to employ processes which only an integrated operator would have any occasion to utilize.

This view of the statute is confirmed by the fact that Congress has listed, for specified minerals, certain processes which may constitute "ordinary treatment processes" and others which are excluded from that category. This listing, upon examination, shows that Congress has included only processes which particular segments of the mining industry might have to employ in order to obtain the valuable constituent of the mineral deposit in usable or marketable form. For example, in the case of minerals "which are customarily sold in the form of a crude mineral product," Congress has identified and allowed various processes which might be necessary "to bring to shipping grade and form." In the case of metal mines, it has excluded smelting and refining—processes which take place after the ore concentrate (saleable, at that stage, to smelters) has been obtained.

We emphasize additionally that the concept of "ordinary treatment processes" (as well as the statutory references to particular processes which may satisfy that concept) is in full accord with the mining industry's own view of the scope of mining (a view, as we show under Point II, made fully known to Congress). As the technical treatises and trade journals repeatedly explain, mining, broadly speaking, is regarded as including certain ordinary preparatory processes employed after extraction of the mineral to separate the valuable constituent of the natural deposit from waste

matter. The separation—accomplished by treatment processes variously designated as ore dressing, mineral dressing, milling and beneficiation—yields the valuable mineral in varying degrees of purity or in controlled mixtures. Putting minerals in shipping grade or form may require, in some instances, such preparatory processes as crushing, screening, or drying. The significant point is that the recognized mineral treatment processes do not destroy the physical and chemical identity of the minerals; all of them are distinguished from the processes of manufacture, which involve the mechanical or chemical transformation of inorganic and organic substances into new products.

Accordingly, whether one looks to the general language and scheme of the statute or to the particularized and technical meanings of the terminology incorporated in it, these conclusions emerge: (1) that Congress has adopted a standard applicable to each class of mine, not one that varies from taxpayer to taxpayer; (2) that the treatment processes which are included within "mining" are of a definite and restricted kind, so that there is for each mineral an ascertainable and uniform cut-off point binding upon all miners—integrated or non-integrated—of that mineral; and (3) that the cut-off is at that point where the necessary treatment of the mineral has brought it to the stage where it is fit for sale or commercial use.

II

The legislative history establishes that there is no room for any other interpretation of the statutory definition of "mining."

A. Although percentage depletion was first authorized in 1926 (for the oil and gas industry), provision for depletion of natural deposits dates back to the first income tax statute in 1913. Under the early depletion provisions, it was also necessary to draw lines in order to determine what portion of a taxpayer's income should be deemed to reflect an exhaustion of mining property. Although it was not until 1943 that the statutory definition of mining here in issue was adopted, this definition represents a codification of concepts which had developed over the preceding thirty years. It is accordingly necessary to trace the evolution of mineral depletion from its beginning.

1. (*1913–1924*). The Income Tax Act of 1913 provided that there might be deducted from net income "a reasonable allowance for the exhaustion * * * of property * * * not to exceed, in the case of mines, 5 per centum of the gross value at the mine of the output for the year." The Treasury Regulations thereafter provided that "gross value at the mine" meant the market value of the mineral product "at the mine," but that if market value of the product was established at some other place, "transportation, reduction and smelting charges" were to be deducted.

The 1916 Act limited the annual allowance to "the market value in the mine of the product thereof." Under both the 1913 and 1916 Acts, the aggregate of the annual allowances might not exceed the investment in the property or its 1913 value.

In 1918, Congress authorized so-called "discovery" depletion. Under this method, value (which may exceed cost) at or about the time of discovery is esti-

mated and depletion is taken with reference to that figure.

In 1921, the statute was amended to provide that annual depletion could not exceed net income derived from the property during the tax year—a step taken to prevent taxpayers from offsetting depletion allowances against profits earned in other business activities. The implementing Treasury Regulations provided that gross income (from which the net income limitation was to be derived) was to be computed, in the case of the integrated miner, on the basis of "the market or field price of the raw material before conversion [into a refined product]."

In 1924, Congress approved these regulations and set the ceiling on depletion at 50% of "net income * * * from the property."

2. (*1926*). In the mid-1920's, discovery depletion was widely criticized because of the great difficulties involved in appraising the value and capacity of newly discovered mines and the resulting prejudice to many small miners. Percentage depletion was adopted, but solely for the oil and gas industry, in 1926 as a method which would provide "simplicity and certainty in administration." Percentage depletion was to be based on the "gross income from the property." Congress stated, in a joint committee report, that gross income "must be computed from the production and posted price of oil, as the gross receipts from a refined and transported product can not be used in determining the income as relating to an individual tract or lease." Treasury Regulations, in conformity with this declaration, provided that

"gross income shall be assumed to be equivalent to the market or field price of the oil and gas before conversion or transportation."

3. (*1932*). After repeated proposals had been made to several Congresses, beginning in 1927, percentage depletion was extended, in 1932, to metal mines, coal and sulphur. Again, it was urged by proponents that discovery depletion was intolerably difficult to administer and that costly appraisals were beyond the means of small miners. Percentage depletion was urged by the American Mining Congress and others as a simple means of taking account of the economic fact that a portion of the miner's natural deposit is used up in the operation of the mine. The American Mining Congress represented that "gross income from the property" (which had served as the depletion base for oil and gas) has a "definite, fixed meaning" and might be readily applied "in accordance with the trade practice of the different branches of the mining industry." A leading mining association representative stated that percentage depletion "would put us all on the same basis, absolutely." The sulphur representative advised that since sulphur had a market value as produced there would be no need, in the case of that mineral, for "any allocation [between mining and advanced processing] in determining the income to which percentage depletion is applicable."

In its studies of the problem, Congress paid particular heed to the fact that some large metal mine operators performed their own smelting and refining. It concluded that their regular accounting practices would permit them to eliminate the enhancement re-

sulting from smelting and refining and to compute the value of the ore on the same basis "as the smaller operator who sells to a smelter or its agent."

The statute, as passed in 1932, followed the same approach as previously adopted in relation to oil and gas, authorizing depletion in terms of percentages of the "gross income from the property," but not to exceed 50% of the net income from the property.

The Treasury Regulations, which were promptly promulgated, recognized that mining, in trade practice, may extend beyond mere extraction, and they allowed for normal and necessary processing of ore to the marketable stage. Some processes were listed; others were broadly described in the same manner later adopted in Section 114(b)(4)(B). Significantly, special provision was again made for the case of the integrated operator. If there was a representative market price in the area for the basic mineral product of the industry, the integrated operator was to compute his gross income constructively on the basis of that price; if not, the receipts from the sale of the product actually sold were to be reduced by the cost of all extraordinary processes applied.

4. (*1943*). In 1942, mining industry representatives presented two grievances to Congress. The first was that the Treasury Department had departed from the original understanding as reflected in the 1932 regulations and was disallowing certain processes—notably, cyanidation of gold, said to be the equivalent of concentration (a specifically allowed process), and the furnacing of quicksilver, said to be a prerequisite to disposition of that mineral—which were a part of

the necessary preparation of minerals for market. Although it was argued that the Treasury had thus construed "ordinary treatment processes" too restrictively, the mining industry foreswore any purpose to claim depletion on the basis of advanced processes, stating, "Obviously it was not the intent of Congress that those processes which would take your products and make them into different products having very different uses should be considered as the basis of depletion."

The second grievance was that the Treasury, by its 1940 regulations, had taken steps to exclude the profits, as well as the costs, which might be ascribed to advanced processing. These regulations had formulated the so-called "proportionate profits" test (a test which is still called for by Treasury Regulations). Under this test, if a taxpayer engages in advanced or abnormal processing and there is no representative market or field price in the area for the basic mineral product of the industry, there is to be an allocation as between the costs and profits attributable to ordinary treatment processes and those attributable to further processes, the former to constitute the "gross income from the property."

In 1943, Congress, acting in response to the first grievance, wrote the 1932 Treasury Regulations into the statute, adopting the definition of "mining" here in issue and stating (in the words of the Senate Finance Committee):

> The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain

> a marketable product should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines. * * *
>
> The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the Bureau practices and procedures thereunder. It is therefore made retroactive to the date of such original provisions.

Congress refused to modify the proportionate profits computation, a computation which is made under Treasury Regulations *only* where a taxpayer markets a finished product and there is no representative market price for the basic mineral product.

5. (*1943–1954*). In the years since 1943, Congress has retained the same scheme of mineral depletion. Provision has been made for inclusion (subject to certain limitations as to distance) of transportation, but this has been carefully confined to transportation to the point where "the ordinary treatment processes are applied." Percentage depletion has been extended to numerous minerals not previously covered (including fire clay and shale), but without any change in the criteria governing computation of the depletion base. As the Senate Finance Committee observed in relation to certain minerals as to which percentage depletion was proposed in 1949:

> It is not proposed to allow percentage depletion with respect to the value added as the result of grinding or other special preparation

> because many of the extractors do not themselves carry on this process, but rather sell these minerals in crude form and let others carry on any processing required. Thus to allow percentage depletion with respect to this added value would discriminate against those selling these minerals in crude form, since percentage depletion is not allowable to processors.

The latest enactment—the 1954 Code (not directly in issue here)—retains the same basic definition of mining which Congress had evolved over the preceding years.

B. From this history, several propositions emerge clearly. Congress proposed to avoid economic discrimination, particularly against the small miner. To this end, it undertook to establish a uniform standard for determining, in relation to each class of mine, the scope of "mining." Each segment of the industry was to be effectively limited in that its members could include only the ordinary mineral treatment processes customary in the trade and required to put the mineral in its marketable state. From the beginning, Treasury Regulations—regulations which Congress has repeatedly approved—have proceeded on the premise that extraordinary or advanced processing, such as that which might be employed by an integrated operator, would have to be excluded. When the Chairman of the House Ways and Means Committee asked the Chairman of the Tax Committee of the American Mining Congress whether one must be careful in defining mining so as "to separate the value added by manufacturing," the latter replied, "Yes, I think we should."

He further explained that "the ordinary treatment processes which are normally applied to bring your minerals into a marketable condition" were mining and not manufacturing costs.

There is one striking aspect of the legislative history which warrants particular emphasis. Percentage depletion ultimately came to be extended to virtually every significant mineral. Thus, the representatives of almost every branch of mining came before Congress, at one time or another, to state their case. None claimed that mineral depletion might take in manufacturing processes. On the contrary, each undertook to explain to Congress what the basic mineral product was and what processes (if any) were necessary to make that product fit for use or sale. If any of those who urged mineral depletion as a means of compensating miners for the exhaustion of mineral assets secretly contemplated that it might be converted into a bonanza for integrated operators, certainly it did not find expression at any committee hearing.

III

The application of the statute (as we interpret it) to this case presents no difficulty. The court below has found that raw fire clay and shale are sold in substantial quantities—a finding which establishes that fire clay and shale, upon extraction, are marketable mineral products. The error of the court below lies in its conclusion that depletion may be taken on the basis of fabricated products when it appears that the individual taxpayer is not in a position to market the crude mineral product profitably. A mine

does not become more valuable—or entitled to a greater allowance for depletion—because its operating costs are high or its strategic location in relation to the mineral market is poor. Sales are significant for purposes of applying the statute not because an ability to sell profitably is relevant, but only because sales may provide conclusive proof that a mineral product has reached a state where it is fit for commercial or industrial use—proof, in other words, that the mineral has passed beyond the point where it can be said to be undergoing the ordinary processes of "mining."

The *Merry Brothers* group of cases, upon which taxpayer relies, went off on the Government's concession (whether or not such concession was necessary or factually accurate) that the minerals there involved were not sold in their mineral state. Here, of course, the court found as a fact that there is a substantial market for the raw minerals involved.

We note additionally our belief that the legal approach adopted by the courts in *Merry Brothers* and like cases was also mistaken. As our arguments under Points I and II demonstrate, it should make no difference whether a mining industry is non-integrated, partially integrated or fully integrated. The term "ordinary treatment processes" refers to mining processes, and the dependent clause "normally applied * * * to obtain the commercially marketable mineral product" indicates only that miners may claim processes beyond extraction to the extent that such processes are necessary to put the mineral in the condition where it is fit for commercial or industrial use. If

all miners of a particular mineral become integrated, thus providing their own market for the mineral product, the depletion base does not thereby come to comprehend the processes of fabrication and to multiply many times over. Inasmuch as this Court, in this case, will be establishing criteria to which the lower courts will hereafter look in interpreting the statutory definition of "mining," it is, we believe, appropriate that the Court consider the different approaches taken in the decided cases with a view to providing proper guidance for the future.

ARGUMENT

Introduction

Congress has provided a depletion allowance in relation to "mines, oil and gas wells, other natural deposits, and timber" (Section 23(m) of the Internal Revenue Code of 1939, App. A, *infra*, p. 92). As this Court has observed on frequent occasions (*e.g.*, in *Parsons* v. *Smith*, 359 U.S. 215, 220), depletion was designed as an allowance for the exhaustion of wasting assets. *Percentage* depletion (authorized by Section 114(b)(4) of the 1939 Code, App. A, *infra*, pp. 92–94) is simply a statutory method for ascribing value to those assets—a method which was adopted largely because of the difficulties which had been experienced in appraising the value of mineral properties by other techniques. The mechanical or arithmetical aspects of the method are not difficult. Congress has specified various percentages for various minerals.[4] These per-

[4] In the case of fire clay and shale, involved in this case, the percentages are 15 percent and 5 percent, respectively.

centages are to be applied to "gross income from the property" (Section 114(b)(4)(A)), which is in turn defined as "gross income from mining" (Section 114 (b)(4)(B)). The resulting figure represents the amount of depletion which has presumptively occurred; it constitutes the allowance.[5]

The basic problem involved in this case (and in many other cases which are pending administratively or in the courts) is to determine what is included in the concept of "gross income from mining." On this point, the statute states that mining does not include merely the "extraction of the ores or minerals from the ground" (Section 114(b)(4)(B)); it includes also "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products" (*ibid.*). The same section undertakes further to list, in the case of specified minerals, processes which are included in, or excluded from, the concept of "ordinary treatment processes." For example, in the case of coal, "cleaning, breaking, sizing, and loading for shipment" are included. In the case of lead, zinc, copper, gold, silver and certain other minerals, various processes—among them, crushing, grinding and beneficiation by concentration—are included, whereas various other processes—among them, smelt-

[5] There is a ceiling on the allowance. Section 114(b)(4)(A) provides in part: "Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph."

ing and refining—are expressly excluded. The minerals involved in this case—fire clay and shale—are not specifically designated.

The Government's position, advanced in the courts below, is that fire clay and shale are fit for commercial or industrial use in raw form and are in fact sold in that form. The Court of Appeals agreed (R. 270) that "the Government's evidence indicates that large quantities of fire clay and shale were sold during the tax year, 1951." It nevertheless concluded that taxpayer's "gross income from mining"—its depletion base—takes in total receipts from the sale of finished manufactured products, such as sewer pipe, which it fabricates from the ingredient minerals. This was rested upon a finding (which we do not challenge) that taxpayer's costs are such that it could not profitably sell fire clay and shale in their raw form.

Under the Court of Appeals' construction, the scope of mining varies from taxpayer to taxpayer because one must determine, in each instance, what the particular producer can sell at a profit. Indeed, the court expressly recognized (R. 270–271) that the non-integrated miners of fire clay and shale would necessarily be limited, so far as their depletion base was concerned, to the sales price of the minerals in raw form.

Implicit in the court's holding are two fundamental and closely related propositions which, in our view, are erroneous: (1) that the product with reference to which the gross income from mining is computed varies according to the particular product which the

taxpayer, on the basis of his particular operation, finds it profitable to sell; (2) that the phrase "ordinary treatment processes normally applied by mine owners or operators" may be extended to take in processes which could never be employed by one who is strictly a mine operator and can only be utilized by one who is also a manufacturer.

The extreme results to which such a holding leads are readily apparent. Granting that consideration of these practical consequences may not itself be conclusive of the legal issues, the results to which a particular statutory interpretation leads are certainly relevant in determining whether this interpretation is a reasonable one. Thus, we note briefly at the outset the implications of the decision below.

It results, in the first place, in sharp disparities and widespread discrimination. The integrated miner becomes eligible for benefits which must necessarily be denied the non-integrated miner, albeit the statute relates to the depletion of mining properties. In this case, taxpayer, computing depletion on the basis of the sales price of advanced manufactured products, such as sewer pipe, derives a depletion allowance for fire clay and shale amounting to $4.03 per ton. Yet a non-integrated miner in the same area was delivering fire clay and shale to a local manufacturer for approximately $1.40 per ton.[6] His depletion allowance amounts to approximately fifteen cents per ton.[7]

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[6] Sales of fire clay and shale in the Brazil, Indiana, area were at prices ranging from $1.60 to $1.90 per ton. (R. 271.)

[7] For the figures upon which this computation is based, see the Government's petition, pp. 9–10.

Manufacturers who do not own their own mines are also placed at a competitive disadvantage. They cannot obtain the manufacturing subsidies which become available, under the ruling below, to miner-manufacturers.

Finally, there is discrimination among competing miner-manufacturers. Some will be required to take depletion on the basis of a more primitive product than others, for it may be demonstrable that the former can (or do) profitably sell a primitive product.

What has been said in relation to discrimination indicates that there will be a substantial premium placed upon vertical integration and that the type of integration encouraged will be upon a most inefficient basis. The view adopted below rewards the manufacturer who acquires an inefficient mine, for such an acquisition opens the way to his taking depletion upon an advanced manufactured product. It gives rise to what might be termed a Gresham's law of depletion: bad producers drive out good.

Under the Court of Appeals' view, moreover, the possibilities for depletion allowances are virtually limitless. For example, in a case now pending in the Sixth Circuit, *Sparta Ceramic Co.* v. *United States*, 168 F. Supp. 401 (N.D. Ohio), a miner-manufacturer who mines and uses fire clay and shale to make bathroom and floor tile is claiming depletion on the $169 it realized per ton of clay, which is over 50 times the depletion base of a non-integrated clay miner in the same area. A company which mines salt, for which the sales price is about $10 per ton in bulk, is claiming depletion on the sales prices of the salt in the various

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forms in which it is marketed, including four-ounce containers selling at about $1800 per ton. *Morton Salt Co.* v. *United States* (C. Cls., No. 142–58). By the same token, the potential impact upon the revenue is enormous. See petition, pp. 7–8.[8]

From the administrative standpoint, the problems are likewise grave. Congress believed that percentage depletion would provide a simple practical rule susceptible of uniform application.[9] But, under the decision below, the Commissioner may not determine, for each of the various segments of the mining industry, the basic mineral product which establishes the cut-off point. There is no possibility of uniform application. The Commissioner must determine, each year, what products each integrated miner-manufacturer in the United States can, with the particular processes he applies and in the light of his individual facilities and costs, sell at a profit. The difficulties of such investigation and prognosis are so great that the Commissioner, in most instances, would be obliged to presume that the finished products actually manufac-

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[8] We also invite attention to the President's Budget message of January 18, 1960 (reprinted in *The New York Times*, January 19, 1960, p. 17), which stated:

"* * * There is also before the Congress an amendment to prevent unintended and excessive depletion deductions resulting from the computation of percentage depletion allowances on the selling price of finished clay, cement products, and mineral products generally; unless the problem is satisfactorily resolved in a case now pending before the Supreme Court, the need for corrective legislation in this area will continue."

[9] See *infra*, pp. 41–53.

tured by an integrated producer are the only ones which he could profitably market.

We shall argue under Point I that the statute, properly construed, neither requires nor permits these extraordinary results. The definition of "mining," as we read it, imposes an industry-wide test which permits each miner of a particular mineral to include in the depletion base those processes, and only those processes, which are normally required by mine owners to put the mineral in the state where it is fit for commercial or industrial use. It cannot, we think, be fairly interpreted as placing depletion on a basis which varies from taxpayer to taxpayer, much less on one which has the effect of granting a subsidy for manufacturing to those operators who have combined fabrication with mining.

We deal under Point II with the legislative history—a history which has a span of more than forty years and is voluminous. That history, written in large part by members of the mining industry, furnishes overwhelming evidence that depletion was never sought in relation to the manufacture or fabrication of finished products from minerals. Indeed, from the outset, special provision was made for computing the depletion allowance in the case of integrated miner-manufacturers. Congress repeatedly expressed its solicitude that the small non-integrated miner should suffer no disadvantage. Moreover, we find no intimation in the entire history that it was deemed in any way material, from the standpoint of

determining what is included within mining, whether the individual taxpayer could sell the mineral, in its mineral state, at a profit.[10] The purpose of Congress was to allow each miner to include in the depletion base those ordinary processes (by and large, well understood by Congress) which miners normally must apply to put the mineral in a state where it is fit for commercial or industrial use.

In Point III, we consider the particular application to this case of the legal propositions which we believe to be established by an examination of the statute and its history.

I

THE STATUTORY DEFINITION OF MINING ESTABLISHES A UNIFORM STANDARD APPLICABLE TO EACH CLASS OF MINES. EACH MINER OF A PARTICULAR MINERAL MAY INCLUDE IN THE DEPLETION BASE ONLY SUCH ORDINARY TREATMENT PROCESSES AS ARE NECESSARY IN THAT BRANCH OF THE MINING INDUSTRY FOR PURPOSES OF OBTAINING THE BASIC MINERAL PRODUCT FIT FOR COMMERCIAL USE.

The statute, as observed above, provides for the application of specified percentages to "gross income from mining." The crucial language is that which states (Section 114(b)(4)(B)) that mining includes, in addition to the extraction of the ores or minerals from the ground—

[10] The economic implication, of course, if a particular miner could not sell a mineral at a profit, whereas others do so, is that his mine is *less* valuable. It is thus extraordinary to suggest that this circumstance should provide a basis for allowing him, for exhaustion of his mineral property, a *greater* depletion allowance.

> the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable product or products * * *."[11]

On its face, we believe, this language requires the conclusion that Congress has adopted a generic or class description. Congress has not authorized each taxpayer to include such processes as he may use in order to obtain the particular product which he markets. It has authorized only the inclusion of *ordinary* treatment processes *normally* applied by mine owners or operators. We think it inescapable, therefore, that what Congress had in mind was an industry-wide test applicable to each class of mines. The includible processes are those which (1) are "ordinary treatment processes" in the branch of the mining industry concerned, and (2) are necessary in order to obtain, in usable or marketable form, the basic product which such miners wrest from the natural deposits.

The plural reference to products—"the commercially marketable product or products"—is nowise inconsistent with this reading. It is merely a recognition of the fact that one mining operation (as in this case) may yield more than one mineral product (here fire clay *and* shale). Indeed, a single ore frequently con-

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[11] The statutory definition of mining also includes "so much of the transportation of ores or minerals * * * from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical or other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills." This transportation, it is evident, is included as a step which intervenes between extraction and treatment.

tains many different metals. This is reflected in Section 114(b)(4)(B), subparagraph (iv), which speaks of the "processes used in the separation or extraction of the product or products from the ore * * *."

Further evidence of congressional purpose, as found within the four corners of the statute, appears in the listing, for specified minerals, of processes which are eligible for inclusion and processes which are in all events excluded. Section 114(b)(4)(B) goes on to state:

> * * * The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining) or by substantially equivalent processes or combination of processes

> used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. * * *

This listing demonstrates that Congress intended to permit only the inclusion of those processes which are necessary in the particular segment of the mining industry in order to obtain, in usable or marketable form, the valuable constituent of the deposit.

Thus, the treatment processes listed for coal in subparagraph (i)—cleaning, breaking, and sizing—are necessary, at least in the case of anthracite, to put the coal in marketable form.[12]

The processes listed for sulphur in subparagraph (ii) are the required processes for mining sulphur by the commonly utilized Frasch method.[13]

It is sufficient to note, in relation to subparagraph (iii) dealing with minerals customarily sold in crude form, the key words, following the identification of various processes, "to bring to shipping grade and form."[14]

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[12] Richards and Locke, *Textbook of Ore Dressing* (1940 ed.), pp. 501–502; Mitchell, *Coal Preparation*, Seeley W. Mudd Series (1950 ed.), pp. 149, 182–195.

[13] House Hearings, 1932, p. 339 (App. B, pp. 438–439); House Hearings, 1951, p. 1607 (App. B, pp. 440–441). Appendix B to this brief is printed as a separate volume; it is a compendium of legislative and other materials of which the Court may take notice.

[14] At first blush, it may appear inconsistent to state treatment processes for minerals which are customarily sold in the form of a crude mineral product, but this is actually not so. For example, iron ore of shippable grade (at least 50 percent iron) *is* customarily sold without any processing, but taconite, a low-grade iron ore, must be processed. See Senate Hearings, 1942, p. 985 (App. B, pp. 360–361).

The fourth category of ordinary treatment processes (subparagraph (iv)) applies primarily to ores not customarily sold in the form of a crude mineral product. The listed processes include several concentration processes and certain other processes which the mining industry has repeatedly represented as equivalent processes.[15] Concentration is necessary in the case of almost all metallic ores.[16] Even then, the result is not a product which is commercially marketable to the ultimate consumer; the ore still must be smelted or refined (or both) before it is used by fabricators.[17] Numerous miners have smelters and smelt their own ore,[18] but others do not; smelting is a so-called "custom business."[19] Significantly, smelting and refining are expressly excluded from the designation "ordinary treatment processes." The large operator is thus placed in the same category for depletion purposes as the small miner, who sends his ore concentrate to a smelter and is paid what is called the "net smelter return."[20] In short, the cutoff point for ores described in this category is at the conclusion

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[15] See *infra*, p. 59.

[16] Behre and Arbiter, *Distinctive Features of the Mineral Industries*, Economics of the Mineral Industries, (A.I.M.E., 1949 ed.), pp. 62–63.

[17] Taggart, *Handbook of Mineral Dressing* (1945 ed.), p. 2–01.

[18] Behre and Arbiter, *Distinctive Features of the Mineral Industries*, *supra*, p. 74; Joint Committee Report, 1930, Appendix XXXI, p. 63 (App. B, p. 78).

[19] Tyler, *Cost of Acquiring and Operating Mineral Properties*, Economics of the Mineral Industries (1959 ed.), p. 194; Senate Hearings, 1938, p. 484 (App. B, p. 492).

[20] Shepherd Report, pp. 69–70 (App. B, pp. 83–84); Senate Hearings, 1938, p. 484 (App. B, pp. 492–493).

of the first stage of necessary processing—at that stage where the mined mineral has a marketable value in that it is fit for delivery to a smelter.[21]

It should be pointed out further that the statutory scheme, both in its use of the phrase "ordinary treatment processes" and in the listing of particular processes which satisfy that concept, is in accord with the mining industry's view of the scope of mining—a view, as we shall show in our subsequent discussion of the legislative history of mineral depletion, made fully known to Congress. The technical and the trade literature repeatedly explain that mining embraces certain ordinary preparatory processes, employed after extraction, to separate the valuable constituent from waste matter so as to put it in form or grade fit for use.[22]

To miners, "mining" is a "selective" process of obtaining or winning "a marketable product."[23] It is selective because, in addition to the mineral

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[21] As to the third and fourth categories of listed treatment processes, it should be noted that one or more of these may be applicable to unlisted, as well as listed, minerals. On the other hand, not all apply to any one mineral. For instance, cyanidation is a process used only for treating gold and silver. (See trade definitions, App. B, p. 498.) In general, the listing of ordinary treatment processes covers most, but not necessarily all, of the various treatment processes which are applied in the mining industry. As to any given mineral, "mining" includes only such of the treatment processes (whether listed or unlisted) as are "normally applied by mine owners or operators" to the particular mineral "in order to obtain the commercially marketable mineral product."

[22] See the trade definitions set out in Appendix B, pp. 495–500.

[23] Dickinson, *Depletion—Gross Income—The Property*, 18–19 Mining Congress Journal (1932–1933), October 1932 issue, p. 9 (App. B, pp. 467–468).

for which a deposit is worked, the material mined "usually carries one or several waste minerals" and the "market or use requirement" ordinarily necessitates separation of the valuable mineral, in varying degrees of purity or in controlled mixtures of the components.[24] This separation is accomplished by various "Methods of Treatment" or "Treatment,"[25] depending upon the type of mineral, which do not destroy the physical and chemical identity of the mineral.[26] In the industry, all of these various treatment processes are classified as "mineral dressing,"[27] which is substantially the same as "ore dressing" (mineral dressing as applied to ore),[28] "milling" and "beneficiation."[29] Mineral dressing "is commonly re-

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[24] Behre and Arbiter, *Distinctive Features of the Mineral Industries*, *supra*, pp. 45, 60.

[25] See Taggart, *Handbook of Mineral Dressing* (1945 ed.), and particularly the page heading "Methods of Treatment" on pages 2–71 through 2–75 and the other numerous "Treatment" page headings. See, also, Fay, *A Glossary of the Mining and Mineral Industry*, Department of Interior, Bureau of Mines (1947 ed.), p. 699, to the effect that a treatment process in mining means a process "whereby the valuable constituent is recovered." Compare *United States* v. *Utco Products*, 257 F. 2d 65 (C.A. 10th); *Commissioner* v. *American Gilsonite Co.*, 259 F. 2d 654 (C.A. 10th), certiorari denied, 359 U.S. 925.

[26] Behre and Arbiter, *Distinctive Features of the Mineral Industries*, *supra*, p. 62.

[27] Gaudin, *Principles of Mineral Dressing* (1939 ed.), p. 4; Behre and Arbiter, *Distinctive Features of the Mineral Industries*, *supra*, p. 63; Taggart, *Handbook of Mineral Dressing* (1945 ed.).

[28] Gaudin, *Principles of Mineral Dressing* (1939 ed.), p. 1; Stoughton and Butts, *Engineering Metallurgy* (1926 ed.), p. 65.

[29] *Materials Survey—Copper*, U.S. Bureau of Mines with the Cooperation of the Geological Survey, Department of the Interior (Sept. 1952), Ch. II, p. 26.

garded as the processing of raw minerals to yield *marketable products* and waste by means that do not destroy the physical and chemical identity of the minerals."[30] (Italics supplied.) Some mineral materials do not require treatment for waste elimination but may require such preparatory treatment as crushing, screening or drying to meet the minimum marketing requirement.[31] Accordingly, except as to abundant, inexpensive minerals, such as clay,[32] the "winning of a marketable product," which is the "sole objective" of mining,[33] usually requires that the material mined be subjected to certain treatment processes. These processes are considered a part of "mining."[34]

Such processes are also included in "mining" as defined in the Federal Government's *Standard Industrial Classification Manual*,[35] which "defines industries in accordance with the existing structure of the

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[30] Gaudin, *Principles of Mineral Dressing* (1939 ed.), p. 1.

[31] Behre and Arbiter, *Distinctive Features of the Mineral Industries*, *supra*, p. 69.

[32] Ries, *Clay, Industrial Minerals and Rocks*, Seeley W. Mudd Series (1949 ed.), p. 233.

[33] Dickinson, *Depletion—Gross Income—The Property*, *supra* (App. B, p. 467).

[34] See Dickinson, *Depletion—Gross Income—The Property*, *supra* (App. B, pp. 466–468); Gaudin, *Principles of Mineral Dressing* (1939 ed.), p. 1; *Encyclopedia Americana* (1958 ed.), Vol. 19, p. 73; *United Mercury Mines Co.* v. *Bradley Mining Co.*, 259 F. 2d 845, 848 (C.A. 9th); cf. *United States* v. *United Verde Copper Co.*, 196 U.S. 207, 212–213.

[35] *Standard Industrial Classification Manual*, Executive Office of the President, Bureau of the Budget, 1957.

American economy" (p. 431). Thus, the *Manual* states (p. 21):

> The term "mining" is also used in the broad sense to include quarrying, well operation, milling (crushing, screening, washing, flotation etc.), and other *preparation needed to render the material marketable.*[36] [Italics supplied.]

Such processing or preparation is entirely discrete from manufacturing. As the *Manual* states (p. 43), the treatment processes employed in mining to obtain a marketable mineral product "are not considered manufacturing" which, in contradistinction to mining, involves "the mechanical or chemical transformation of inorganic and organic substances into *new products.*" [Italics supplied.]

Whether one looks then to the general language and scheme of the statute or to the particularized and technical meanings of the terminology incorporated in it, these conclusions emerge: (1) that Congress has adopted a standard applicable to each class of mine, not one that varies from taxpayer to taxpayer; (2) that the treatment processes which are included within "mining" are of a definite and restricted kind, so that there is for each mineral an ascertainable and uniform cut-off point binding upon all miners—integrated or non-integrated—of that mineral; and (3) that the cut-off is at that point where the necessary treatment of the mineral has brought it to the stage where it is fit for sale or commercial use. The elaborate legislative history, to which we now turn, does not merely

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[36] It was on this basis that the 1954 census of the mining industry was reported. *1954 Census of Mineral Industries*, Vol. 1, p. 2.

confirm these conclusions; it shows, we believe, that no other interpretation of the congressional purpose is possible.

II

THE LEGISLATIVE HISTORY REQUIRES THE CONCLUSION THAT DEPLETION ON THE BASIS ALLOWED BY THE COURT OF APPEALS WAS NOT SOUGHT BY THE MINING INDUSTRY IN ANY OF ITS NUMEROUS APPEARANCES BEFORE CONGRESS AND THAT CONGRESS NEVER PROPOSED TO PERMIT IT.

To place the significant items of legislative history in meaningful context, it is necessary to trace the evolution of mineral depletion from its beginnings. Accordingly, we shall first trace the history chronologically. We shall then state, with brief references to the principal items of proof, the major conclusions which we believe must be drawn.

The various materials to which we shall have occasion to refer in setting out the rather lengthy history are assembled, for the Court's convenience, in a single separate volume—Appendix B to this brief. We have attempted to print the excerpts set forth in the Appendix at sufficient length so that they will appear in their proper setting.[37] We have endeavored, moreover, to gather in this compendium all of the significant materials. This is not to say that we have printed everything which might have even a remote bearing or that we have not eliminated repetitious matter. To print everything said in all of the relevant hearings and reports would take a number of volumes.

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[37] Much of the language to which we make particular reference in the brief has been italicized in the Appendix.

A. The Evolution of Mineral Depletion: Chronological Review

1. The term "gross income from the property," which appears in Section 114(b)(4) and embraces the definition of "mining" here in issue, has a history which dates back almost to the inception of the depletion allowance in 1913. The term was early interpreted in Treasury regulations to refer to the gross income from the crude mineral, irrespective of whether a taxpayer converted or manufactured the mineral into an advanced product or sold it in crude form.

Under the current tax provisions, as noted above, the base to which *percentage* depletion is applied is the "gross income from the property." This has been so since the method of percentage depletion was authorized in 1926. But even earlier than that, in connection with various predecessor depletion provisions, it had been necessary to draw lines in order to determine what portion of a taxpayer's income (whether gross income or net income) should be deemed to reflect an exhaustion of mining property. Thus, in order to make clear the way in which the internal revenue laws on the subject have developed one must begin with the earliest provisions relating to depletion. We note parenthetically that it was not until 1943 that "gross income from the property" was expressly defined by statute as "gross income from mining" and that "mining" itself was accorded a statutory definition. The significance of the early history is that the 1943 definition of mining (which is also the current definition) represents a codification of concepts which had developed over the preceding thirty years.

The first income tax act in 1913[38] provided that in computing net income there should be allowed as a

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[38] Income Tax Act of 1913, Section II B, c. 16, 38 Stat. 114, 116 (App. B, p. 1).

deduction "a reasonable allowance for the exhaustion * * * of property * * * not to exceed, in the case of mines, 5 per centum of the *gross value at the mine* of the output for the year * * *." (Italics supplied.) The Treasury Regulations promulgated under that Act[39] stated that the "gross value at the mine" meant "the market value" of ore, coal, crude oil, and gas "at the mine," but that if the market value of the "product" of the mine or well was established at some other place, then the gross value was to be the value of the ore, etc., *"less transportation, reduction and smelting charges."* (Italics supplied.)

The 1916 Act[40] limited the annual allowance to "the market value *in the mine* of the product thereof, which has been mined and sold during the year." (Italics supplied.) The aggregate depletion deductions allowable under both the 1913 and 1916 Acts were limited to the taxpayer's investment in the property (cost) or its 1913 value.[41]

In 1918,[42] Congress changed the method of computing the allowance and authorized what has commonly been called "discovery" depletion, under which the allowance was based on the fair market value of the property at the time of discovery or thirty days thereafter (a value which, of course, might exceed investment or cost). The purpose of the

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[39] Treasury Regulations 33 (1914 ed.), Art. 142 (App. B, p. 1).

[40] Revenue Act of 1916, Section 5(a), c. 463, 39 Stat. 756 (App. B, p. 2).

[41] Treasury Regulations 33 (1914 ed.), Art. 142 (App. B, p. 1).

[42] Revenue Act of 1918, Section 214(a)(10), c. 18, 40 Stat. 1057 (App. B, p. 3).

change was to stimulate the discovery of critical minerals.[43] Under this method, the present value of the total estimated quantity of minerals in place was computed, a depletion rate per unit of measure was established, and the yearly allowance was based upon the number of units recovered.

In 1921, the statute was amended to provide that the discovery depletion deduction could not exceed the "net income * * * from the property" computed without the allowance for depletion.[44] This was done in order to make certain that the depletion allowance "shall not be permitted to offset or cancel profits derived by the taxpayer from a separate and distinct line of business * * *."[45] The Regulations promulgated in connection with this net income limitation[46] significantly state:

> Net income is the gross income from the sale of all mineral products and any other income incidental to the operation of the property for the production of the mineral products, less operating expenses, * * * but excluding any allowance for depletion. *If the mineral products are not sold as raw material but are manufactured or converted into a refined product, then the gross income shall be assumed to be equivalent to the market or field price of the raw material before conversion.* [Italics supplied.]

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[43] See House Hearings, 1925, p. 161 (App. B, p. 9).

[44] Revenue Act of 1921, Section 214(a)(10), c. 136, 42 Stat. 227 (App. B, p. 5).

[45] S. Rep. No. 275, 67th Cong., 1st Sess., p. 15 (App. B, p. 5).

[46] Treasury Regulations 62 (1922 ed.), Art. 201(h) (App. B, p. 6).

Three years later, in 1924, Congress again considered the net income limitation on discovery depletion and fixed it at 50 per cent of the "net income * * * from the property,"[47] implicitly approving the outstanding administrative interpretation as to "income from the property."[48] This interpretation was continued in the regulations on discovery depletion until that method of depletion was finally eliminated altogether in 1954.[49]

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[47] Revenue Act of 1924, Section 204(c), c. 234, 43 Stat. 253 (App. B, p. 7).

[48] *United States* v. *Dakota-Montana Oil Co.*, 288 U.S. 459, 466; *Murphy Oil Co.* v. *Burnet*, 287 U.S. 299, 302–303; *Brewster* v. *Gage*, 280 U.S. 327, 337. See also *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90, 99.

[49] The definition of net and gross income from the property remained unchanged until 1932, when gross income was defined to include mining processes normally applied to obtain a marketable product. See Treasury Regulations 62, promulgated under the Revenue Act of 1921, Article 201(h) (App. B, p. 6); Treasury Regulations 65, promulgated under the Revenue Act of 1924, Article 201(h); Treasury Regulations 69, promulgated under the Revenue Act of 1926, Article 201(h); Treasury Regulations 74, promulgated under the Revenue Act of 1928, Article 221(h); Treasury Regulations 77, promulgated under the Revenue Act of 1932, Article 221 (g) and (h), reprinted in part in Appendix B, pp. 135–138. With some modifications discussed later, the regulations under the 1932 Act continued in force until adoption of the 1954 Code when discovery depletion was abandoned. See Treasury Regulations 86, promulgated under the Revenue Act of 1934, Article 23(m)-1(g) and 23(m)-1(h); Treasury Regulations 94, promulgated under the Revenue Act of 1936, Art. 23(m)-1(g) and 23(m)-1(h); Treasury Regulations 101, promulgated under the Revenue Act of 1938, Article 23(m)-1(g) and 23(m)-1(h); Treasury Regulations 103, promulgated under the Internal Revenue Code of 1939, Section 23(m)-1(f) and 23(m)-1(g); Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939, Section 29.23(m)-1(f) and 29.23(m)-1(g),

Two points may be noted in connection with this early history. *First*, the existence of integrated operators who process, refine and fabricate, as well as mine, the mineral was recognized and dealt with from the very beginning. Then, as under later Treasury Regulations, reference was made to the market or field price of the raw material or to the reduction of gross receipts by the cost of non-mining processes. *Secondly*, the terminology developed in connection with the enactment and administration of the early depletion provisions was later chosen to describe similar concepts in connection with percentage depletion. As will be seen, percentage depletion also came to be limited to 50 per cent of the "net income * * * from the property," and the depletion base came to be defined as the "gross income from the property."

2. Percentage depletion, when adopted in 1926 for oil and gas, was based on the "gross income from the property." As previously, this term was interpreted in Treasury Regulations to require computation of the gross income from the property on the basis of the crude mineral and to preclude discrimination as between integrated and non-integrated producers.

By the mid-1920's, considerable opposition had been expressed to the discovery-value method of computing the depletion base. The valuation required was extremely complex and depended upon many variables since, as earlier noted, it was based on an estimate of the present value of newly discovered mineral deposits.[50] Because of the difficulties and discrimina-

reprinted in part, Appendix A, *infra*, pp. 95-96; Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939, Section 39.23(m)-1(e).

[50] An analytic appraisal, for example, was based on an estimate of the number of units in a deposit, an estimate of the

tory results (small producers were at a disadvantage in making costly appraisals), it was suggested that Congress authorize a simpler and more equitable method of computing the depletion allowance.[51]

Against this background, Congress passed the first percentage depletion statute in 1926.[52] Limited to oil and gas, the statute provided for a deduction of 27½ percent of the "gross income from the property"; it retained the same limitation which had been previously applicable to discovery depletion, namely, that the allowance should not exceed 50 percent of the "net income * * * from the property." The 27½ percent figure was used as representing the average amount of depletion allowed oil and gas operators under discovery depletion as compared with the average gross income from production.[53] It was thought that the percentage system would achieve substantially the

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productive life of the deposit and an estimate of the amount for which the mineral product would be sold when produced. The present value of the right to such prospective income was then computed and a depletion rate per unit established. In any given year, this rate was multiplied by the number of units removed to calculate the depletion allowance. See, generally, Partial Report of the Select Committee on Investigation of the Bureau of Internal Revenue, S. Rep. No. 27, 69th Cong., 1st Sess., reprinted in part in Appendix B, pp. 11–16.

[51] Senate Hearings, 1926, pp. 153–154, 158, 177–180 (App. B, pp. 17–21); Senate Debate, 1926, 67 Cong. Rec. (Part 4), pp. 3762, 3767 (App. B, pp. 27, 28); see, also, Partial Report of the Select Committee on Investigation of the Bureau of Internal Revenue, 1926, pp. 55–56, 116 (App. B, pp. 13–15, 15–16).

[52] Revenue Act of 1926, Section 204(c), c. 27, 44 Stat. 9 (App. B, pp. 30–31).

[53] See Senate Debate, 1926, 67 Cong. Rec. (Part 4), pp. 3762, 3763, 3767, 3772 (App. B, pp. 26–29); see, also, Senate Hearings, 1926, pp. 199–200 (App. B, pp. 22–23).

same result without the complexities attending discovery-value computations. Thus, the House Conference Report [34] on the provision stated:

> The administration of the discovery provision of existing law in the case of oil and gas wells has been very difficult because of the discovery valuation that had to be made in the case of each discovered well. *In the interest of simplicity and certainty in administration* the Senate amendment provides that in the case of oil and gas wells the allowance for depletion shall be 30 percent of the gross income from the property during the taxable year. The provision of existing law limiting this amount to an amount not in excess of 50 percent of the net income of the taxpayer from the property is retained. [Italics supplied.]
>
> The House recedes with an amendment providing that the depletion deduction based upon gross income in the case of an oil and gas well shall be 27½ percent of that income instead of 30 percent * * *.

As was true under the earlier laws, the "gross income from the property" (which, under the 1926 law, became the depletion base) was soon defined by regulations to exclude the enhanced value added by manufacturing or converting activities of the taxpayer. (*Infra*, p. 44.)

In 1927, the Joint Committee on Internal Revenue Taxation [35] issued a preliminary report on the expe-

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[34] H. Conf. Rep. No. 356, 69th Cong., 1st Sess., p. 31 (App. B, p. 29); see, also, S. Rep. No. 52, 69th Cong., 1st Sess., pp. 17–18 (App. B, pp. 25–26).

[35] Created by Section 1203 of the Revenue Act of 1926, c. 27, 44 Stat. 9, the Joint Committee consisted of five mem-

rience had with percentage depletion of oil and gas.[36] The report recognized that some operators did not sell the crude product and reasoned that in computing gross income from the property in such situations there would have to be a cutback to measure the income from the basic marketable product of the industry. Thus, the report stated:[37]

> "Gross income from the property" may be defined, therefore for oil and gas properties, as the gross receipts from the sale of oil and gas as it is delivered from the property less the royalties paid in cash, if any. As it is not customary for operators to report oil royalties as a part of their receipts ordinarily, gross income will coincide with gross receipts. * * * *In the case of taxpayers who are operators, refiners, transporters, etc., the gross income from the property must be computed from the production and posted price of oil, as the gross receipts from a refined and transported product can not be used in determining the income as relating to an individual tract or lease.* [Italics supplied.]

The report also noted that "gross income from the property" was a convenient measure because reference to that figure had been necessary to compute the net income limitation under discovery depletion.[38]

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bers of the House Ways and Means Committee and five members of the Senate Finance Committee, charged with the duty to investigate and report on the effect and operation of the federal tax laws.

[36] Joint Committee Report on Depletion, 1927 (App. B, pp. 32–34).

[37] *Ibid.* (App. B, p. 33).

[38] *Ibid.* (App. B, p. 34).

The Treasury Regulations implementing the percentage depletion allowance for oil and gas [59] confirmed the understanding of the Joint Committee that a taxpayer who did not sell the basic product had to compute the allowance as if he had:

> * * * If the oil and gas are not sold on the property but are manufactured or converted into a refined product or are transported from the property prior to sale, *then the gross income shall be assumed to be equivalent to the market or field price of the oil and gas before conversion or transportation.* [Italics supplied.]

The interpretation of the Joint Committee and of the Treasury was later expressly approved by three courts of appeals. See *Brea Cannon Oil Co.* v. *Commissioner,* 77 F. 2d 67 (C.A. 9th), certiorari denied, 296 U.S. 604; *Consumers Natural Gas Co.* v. *Commissioner,* 78 F. 2d 161 (C.A. 2d), certiorari denied, 296 U.S. 634; *Greensboro Gas Co.* v. *Commissioner,* 79 F. 2d 701 (C.A. 3d), certiorari denied, 296 U.S. 639. It was also implicitly approved by this Court in *Helvering* v. *Twin Bell Oil Syndicate,* 293 U.S. 312, 321.[60] These opinions explained that such limitations were necessary to prevent discrimination and to further the obvious intent of Congress. Thus,

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[59] Treasury Regulations 74 (1929 ed.) promulgated under the Revenue Act of 1928, Art. 221(i) (App. B, pp. 64–65).

[60] In the *Twin Bell* case it was stated (p. 321) with respect to "gross income from the property": "The phrase, we think, points only to the gross income from oil and gas. Compare *United States* v. *Dakota-Montana Oil Co.*, 288 U.S. 459, 461; *Greensboro Gas Co.* v. *Commissioner*, 30 B.T.A. 1361."

in *Consumers Natural Gas Co., supra*, Judge Learned Hand traced the statutory development of percentage depletion and concluded that it was intended to be an approximation of capital exhaustion which could not include in its base the value added by post-extraction processes, stating (pp. 161–162):

> * * * Because the formula is rude and imperfect, we are not justified in injecting into the "basis" the added value imparted to the output by work done upon it after it reaches the surface. That cannot fail to make the deviation greater and to introduce a variable which adds a quite unnecessary discrimination to a result arbitrary enough at best.[61]

To summarize, percentage depletion was devised as a system which would lend itself to simple administration and would eliminate the complexities and discriminations of discovery depletion. It was based on the existing concepts of gross and net income from the property. The statutory standard thus adopted was an objective, industry-wide standard uncontrolled by a particular taxpayer's decision to engage in manufacturing or refining activities; the depletion base of the integrated operator, like that of the non-integrated producer, was measured by the market

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[61] Similar language appears in the Third Circuit's opinion in the *Greensboro* case, *supra*, where it was stated (p. 701):

"If, as the taxpayer contends, the allowance was based on the value of its sales of gas to its consumers, the taxpayer would in effect enjoy an allowance for depletion on its distributing system which is already subject to an allowance for depreciation, and it would, since it both produces and distributes natural gas at retail, enjoy an unusual advantage over the mere producer of gas in the field."

value of the first marketable mineral product of the oil and gas industry.

3. When percentage depletion was extended to metal mines, coal and sulphur in 1932, it was again based upon "gross income from the property." Treasury Regulations were again drawn to require all producers of the same mineral to compute depletion on the same basis, albeit they made allowance for the fact that, in relation to these minerals, the basic marketable products are obtained only after the application of certain treatment processes.

The proposal to extend percentage depletion to metal mines was made to the House Ways and Means Committee during its hearings on revenue revision in 1927. The representative of the American Mining Congress urged that depletion for metal mines should be computed, as in the gas and oil industry, on a percentage-of-income basis.[62] The percentage system was urged because it would provide "a simple, definite method, easy of application, that permits the prompt and final determination of the tax liability."[63] It was also urged[64] that it

> removes the discrimination against the large number of smaller taxpayers who do not have the technical staffs or who feel unwarranted in going to the expense of engaging the professional services necessary to the establishment of discovery depletion under the present plan.

In a brief submitted to the Committee, the American Mining Congress repeated that its plan was to give specified minerals the same type of depletion allowance as oil and gas. The brief recommended that

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[62] House Hearings, 1927–1928, pp. 505–512 (App. B, pp. 36–47).
[63] *Id.* at p. 506 (App. B, p. 37).
[64] *Ibid.* (App. B, p. 38.)

"gross income from the property" be used as the depletion base, stating:[65]

> The phrase "gross income from the property" is used in existing statute, and, *if applied in accordance with the trade practice of the different branches of the mining industry,* has a definite, fixed meaning that is well understood in the industry. Fifteen percent of the gross income from the property is accordingly an amount easily and definitely ascertainable. * * * [Italics supplied.]

In 1927, an amendment incorporating the American Mining Congress' recommendation was introduced on the floor of the House, but it was withdrawn on the understanding that the matter would receive additional study.[66]

In 1928, the American Mining Congress made the same recommendation to the Senate Finance Committee.[67] The information supplied the Committee indicated that a study of percentage depletion in respect of minerals other than oil and gas had been undertaken jointly by the Treasury and the Joint Committee and that sufficient data had been gathered to enable Congress to decide on the rate which would afford the mining industries approximately the same quantum of depletion as under the discovery method.

In 1930, the staff of the Joint Committee issued a preliminary report based on the investigations which had been under way since 1927.[68] This study, com-

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[65] *Id.* at p. 510 (App. B, p. 45).

[66] House Debate, 1927, 69 Cong. Rec. (Part 1), pp. 599–600 (App. B, pp. 47–52).
B, pp. 47–52).

[67] Senate Hearings, 1928, pp. 304–317 (App. B, pp. 52–61).

[68] Joint Committee Report, 1930 (App. B, pp. 66–75).

monly known as the Parker Report, noted that there were several alternative methods of simplifying the computation of the depletion allowance; it recommended a method based upon a percentage of *net income from the property.*[69] The report stated that the existing situation under discovery depletion was intolerably difficult to administer and resulted in discrimination both as between mining industries and as between individual miners in the same industry. The preference for *net* income from the property as the depletion base was rested in part upon the fact that this language had been in the discovery depletion laws and was a concept with which the mining industry had become familiar. It was also noted, however, that there had been considerable support for a test based upon percentage of *gross* income from the property. To indicate the details of that proposal, there was appended to the report the brief of the American Mining Congress filed with the Ways and Means Committee in 1927, as well as a report recommending that approach (Appendix XXXI) which had been prepared by a mining engineer of the Joint Committee. Inasmuch as the standard ultimately chosen was a percentage of *gross* income from the property, this appendix, called the Shepherd Report,[70] came to be regarded as the definitive work on the subject.

The Shepherd Report begins by stating that its purpose is to supply data for consideration by Congress in adopting a simplified percentage rate for

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[69] *Ibid.* (App. B, pp. 70–75).

[70] Pertinent portions of the Shepherd Report are also printed in Appendix B, pp. 76–87.

computing depletion.[71] Mr. Shepherd had spent several months collecting data from operators representing 75 per cent of the total production of the industries concerned.[72] This data showed that the average depletion deduction allowed under discovery depletion for metal mines was 17.127 per cent of the "net smelter returns or equivalent."[73] Net smelter return is the payment which a metal miner receives from a smelter and represents the market value of the metallic content of his ores, less transportation and smelting charges.[74] Based on this percentage, the Shepherd Report recommended that 15 per cent of the "gross income from the property," with a 50 per cent net-income limitation, would be a reasonable depletion allowance for metal mines.[75]

The report observed that, as with oil and gas, there would have to be a special provision for integrated operators.[76] After noting that in the case of the small operator almost all of the ore is sold to smelters in the crude or semirefined (concentrate) form so that the gross income from the property would simply be the net smelter return,[77] the report goes on to state that[78]—

> In the case of the large mine operators with complete plants for concentrating, smelting,

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[71] Shepherd Report, pp. 63–64 (App. B, pp. 76–77).

[72] *Id.* at p. 63 (App. B, p. 76).

[73] *Id.* at p. 65 (App B, p. 80).

[74] *Id.* at pp. 69–70 (App. B, pp. 83–84; see also explanation of net smelter return in Senate Hearings, 1938, pp. 484–485 (App. B, pp. 492–493).

[75] Shepherd Report, p. 66 (App. B, pp. 80–81).

[76] *Id.* at p. 68 (App. B, p. 82).

[77] *Id.* at pp. 69–70 (App. B, pp. 83–84).

[78] *Id.* at p. 70 (App. B, p. 84).

refining and marketing, the practice in accounting from a tax-reporting standpoint is more or less the same as the smaller operator who sells to a smelter or its agent.

Most of them do custom work and therefore must keep accounts of the cost of refining ores from their own properties in a similar manner as is done with purchased ores. Therefore the net smelter return basis can apply equally to their own operations.

The report does suggest [79] that in the case of a few metals, where the customary mining practice was to market the *refined* metals, the gross income from the property should be the "competitive market receipts, or its equivalent, received from the sale of the crude, partially beneficiated or refined gold, silver, or copper, the product actually disposed of by the taxpayers to govern the method of computation of receipts in all cases." [80] In the case of all other metals, the suggested rule was that the gross income should be "the competitive market receipts, *or its equivalent*, received from the sale of *the crude products, or concentrates* on an f.o.b. mine, mill, or well basis." (Italics supplied.)[81]

In essence, the Shepherd Report found that the same system that applied to oil and gas could be adapted

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[79] *Id.* at p. 71 (App. B, p. 87).

[80] As will be seen, this suggested rule was not adopted. Instead, these and other "ores which are not customarily sold in the form of a crude mineral product" were limited to certain named treatment processes or their equivalent. Treasury Regulations 77, promulgated under the Revenue Act of 1932, Art. 221(g)(4) (App. B, pp. 135–138).

[81] Shepherd Report, p. 71 (App. B, p. 87).

to metal mines, with some modification to take into account the fact that certain processes are normally applied to the crude ore in order to put it in a marketable state. There was no intimation of any change in the established principle that a taxpayer's manufacturing activities have no effect on the computation of a depletion allowance. Indeed, in later (December 1930) hearings before the Joint Committee,[82] the Treasury opposed the extension of percentage depletion to metal mines on the grounds that there was no established market value for crude ore (as there was with oil and gas) and that operations of integrated taxpayers selling a refined or finished product would create the administrative difficulty of—

> dividing up the resulting income among all those various activities—marketing, transporting, smelting, refining, mining, etc.—and then allocating the proper portion to the mining operation which would be the income from the mine.[83]

The industry representative, however, stated that this objection was unrealistic because computation of both gross and net income from the property had been previously required and because taxpayers and Treasury officials were already familiar with the concepts.[84]

In 1932, the representatives of the metal mining industry again appeared before the committees of Congress seeking extension of percentage depletion, urging that it had worked well for oil and gas and that metal

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[82] Joint Committee Hearings, 1930 (App. B, pp. 88–107).
[83] *Id.* at p. 110 (App. B, p. 105).
[84] *Id.* at pp. 57–58 (App. B, pp. 101–103).

mines were entitled to the same benefits.[55] It was represented that passage of such a statute would not be detrimental to the revenue and might even result in a net gain for the Government since savings of administrative expenses would more than offset any apparent loss of revenue.[56] Citing the Shepherd Report, the metal mining industry said that 15 percent of gross income from the property would be a fair rate.[57] In defending the need for a percentage depletion allowance, these representatives repeatedly urged that the depletion deduction is simply a way of reflecting the economic fact that a portion of a miner's receipts represents a return of capital. For example, it was stated:[58]

> Depletion of mines under our income tax laws means an annual deduction from gross income of an amount which is estimated will compensate the miner for the capital which has been used up or destroyed through the operation of his mine during the year. Obviously all the ore in his mine at the beginning of his operation is capital. Plainly, also, when he takes that ore out of the mine and sells it he has disposed of his capital. * * * The only question which has been considered in past income tax laws, and which is being considered here, is: "What is the proper method of ascertaining the amount of the

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[55] House Hearings, 1932, pp. 327–337 (App. B, pp. 108–112); Senate Hearings, 1932, pp. 224–235 (App. B, 122–129).

[56] Statement of Donald A. Callahan, representing the Northwestern Mining Association, Senate Hearings, 1932, p. 235 (App. B, p. 129).

[57] *Ibid.* (App. B, p. 129).

[58] *Id.* at p. 225 (App. B, p. 123).

proceeds of his sales of ore which may be regarded as return of capital and upon which he should pay no tax?"

It was again stressed that percentage depletion was absolutely necessary to eliminate existing discrimination between taxpayers. "The adoption of this plan would put us all on the same basis, absolutely." [89]

Spokesmen for the coal industry advanced the same contentions and argued additionally that the coal industry was severely depressed and needed tax relief.[90] They also urged that, since a large segment of the coal industry was producing captive tonnage which was sold on the basis of cost, percentage depletion should be tied to gross income from the property, rather than net income therefrom.[91]

The sulphur representatives testified [92] that percentage depletion would be particularly suitable to that industry because sulphur was prospected for and produced much like oil and gas and frequently came from the same property or type of deposits. It was stressed that sulphur had a market value as it was produced, thus eliminating "any allocation in determining the income to which percentage depletion is applicable." [93]

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[89] *Id.* at p. 230 (App. B, p. 125).

[90] Brief of the National Coal Association and sundry district associations of bituminous mine operators, House Hearings, 1932, pp. 342–346 (App. B, pp. 117–122). This brief was also submitted to the Senate Finance Committee, Senate Hearings, 1932, pp. 236–242 (App. B, pp. 129–130).

[91] House Hearings, 1932, p. 345 (App. B, p. 120).

[92] Statement of E. T. Cummins, representing domestic sulphur producers and brief on behalf of sulphur producers, House Hearings, 1932, pp. 337–341 (App. B, pp. 113–117).

[93] *Id.* at p. 341 (App. B, p. 116).

As enacted,[94] the statutory authorization of percentage depletion for coal, sulphur and metal mines followed the same approach as the oil and gas provision of the 1926 Act and was stated simply in terms of percentages of the "gross income from the property," but not to exceed 50 percent of the net income from the property. Again, the meaning of that term was left to administrative definition.

As pointed out both at the hearings and in the Parker and Shepherd Reports, application of the "gross income from the property" base to metal mines was not as easy as it had been with oil and gas, which is marketable as it comes from the well.[95] Most metallic ores require treatment to remove some of the extraneous matter or waste before they can be sold or transported to a smelter.[96] The processes by which this is done—in the industry, covered by the various terms "beneficiation," "concentration," "mineral dressing," and "ore dressing"—are means of separating out waste material without changing the physical or chemical identity of the mineral.[97] These processes are applied by the miners themselves. After beneficiation, the normal procedure, as Congress was advised,

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[94] Revenue Act of 1932, Section 114(b)(4), c. 209, 47 Stat. 169 (App. B, pp. 133–134).

[95] Joint Committee Hearings, 1930, p. 50 (App. B, p. 101); Joint Committee Report, 1930, p. 68 (App. B, p. 82).

[96] Behre and Arbiter, *Distinctive Features of the Mineral Industries*, *supra*, pp. 45, 60.

[97] For trade definitions of "beneficiation" and "concentration," see App. B, p. 496. "Mineral dressing" includes "concentration," and "ore dressing" is mineral dressing applied to ores. Gaudin, *Principles of Mineral Dressing* (1939 ed.), p. 1.

is to ship the ore concentrates to the smelter, who then remits the value of the mineral content of the shipment to the miner based on the market price of the metal, but less the smelter's charge for treatment."

The drafting of the interpretative regulations was begun shortly after the passage of the 1932 Act and was completed only after protracted consultations with industry representatives, particularly the spokesmen of the American Mining Congress.[2] These regulations were later codified [1] and are therefore of particular significance.

Initially, the Treasury rejected the net smelter return standard proposed by the industry and supported by the Shepherd and Parker Reports.[2] Ultimately,

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[2] See Senate Hearings, 1938, pp. 484–485 (App. B, pp. 491–492).

[2] See Fernald, *Depletion and Related Problems under the Revenue Act of 1942*, 21 Taxes, The Tax Magazine, p. 141 (1943) (App. B, p. 483); Statement of Donald H. McLaughlin, representing the Tax Committee of the American Mining Congress, Senate Hearings, 1943, p. 527 (App. B, p. 202); Statement of Henry B. Fernald, Chairman, Tax Committee, American Mining Congress, Senate Hearings, 1950, p. 781 (App. B, pp. 278–279).

[1] See *infra*, pp. 58–64.

[2] The American Mining Congress submitted several memoranda to the Treasury Department during the consideration of these regulations, setting forth its views on the proper application of the statute. A memorandum dated November 29, 1932, signed by H. B. Fernald, Chairman, Tax Committee, suggested as a possible alternative to the "net smelter return" concept an interpretation based on the gross receipts of the individual taxpayer regardless of the stage at which he sold his product. This proposal, along the lines suggested in the Shepherd Report (App. B, pp. 76–87) for metallics usually sold in refined form, was that—

* * * "For the purpose of this subdivision 'the gross income

however, it acceded to the view that the normal and necessary processing of ore to the marketable stage should be included in computing gross income from the property. The Treasury Regulations promulgated under the 1932 Act [3] adopted this standard. They take the position that "gross income from the property" includes the preparation or treatment processes normally applied and necessary to obtain a marketable product.[4] Thus, the includible treatment processes were listed for certain minerals; others were broadly described in the same manner later adopted in Section 114(b)(4)(B). "Gross income from the property" was defined in the regulations as the amount for which the taxpayer sold the crude mineral product or the product derived therefrom, but not to exceed the amount which would have been received if different

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from the property' shall be the competitive market receipts, or their equivalent, received from the sale of the crude, partially beneficiated, or refined metal, the product actually disposed of by the taxpayer to govern the method of computation of receipts in all cases."

However, the memorandum went on to state that a net smelter return basis would be preferable because the alternative would be—

"subject to the possible objection that it might not give the same depletion base to all the taxpayers in any particular division of the industry, but one might receive more and another less according to the particular way in which it happened to dispose of its product. Also it may be urged that such a regulation would not be in accord with the regulations as to oil which require the use of the basis on which oil production is ordinarily sold in that industry, regardless of how a particular taxpayer may dispose of its own product."

[3] Treasury Regulations 77, Art. 221(g) (App. B, p. 135).

[4] See discussion in fn. 2, *supra*, pp. 55–56.

or advanced (*i.e.*, other than normally required) processing had not been applied. If there was a representative market or field price in the area for the basic marketable product of like kind and grade, that was to determine, for the integrated producer, the gross income from the property. If not, the receipts from the sale of the product actually sold were to be reduced by the cost of all the extraordinary processes applied.

The alternative methods of computing the depletion base of integrated operators—representative market price or exclusion of processing costs—were the same as previously used for the same purpose for oil and gas, and, earlier, in applying the percentage limitation under the 1913 Act. Additional processing after the marketable stage had not been included in "gross income from the property" in the case of oil and gas, and the same principle was purposefully adopted for the new minerals.[5] This was fully recognized in the mining industry after passage of the 1932 Act. In an article appearing in the October 1932 issue of the Mining Congress Journal written by a member of the staff of the American Mining Congress,[6] it was stated:

> It is generally understood that gross income is the amount of money received for, or the value of the marketable or shipping product of, a natural resource enterprise. The production

[5] See, *e.g.*, Joint Committee Hearings, 1930, p. 50 (App. B, p. 101); House Hearings, 1932, pp. 339–340 (App. B, pp. 115–116).

[6] Dickinson, *Depletion—Gross Income—The Property*, 18–19 Mining Congress Journal (1932–1933), October 1932 issue, p. 9 (App. B, p. 467).

of coal or ore, of metals or non-metals is carried on from the prospecting and discovery stages with the sole objective of developing and bringing into being a marketable shipping product of value. This value is the gross income.

4. ***The statutory definition of "gross income from the property," including the definition of "mining", was added to Section 114(b)(4) in 1943 at the request of the mining industry, and made retroactive to 1932, as a ratification and codification of the original administrative practice under the 1932 Treasury Regulations and in confirmation of the prior understanding of the mining industry that the allowed processes included all which were necessary in order to make the mineral fit for commercial use.***

After the extension of percentage depletion (in 1932) to metal mines, coal and sulphur, and the issuance of the interpretative regulations, there were no significant legislative or administrative developments for several years. During this interval the Revenue Acts of 1934,[7] 1936,[8] and 1938[9] and the Internal Revenue Code of 1939 were successively passed with only minor (and here irrelevant) amendments to the percentage depletion provision.

However, in 1942, industry representatives appeared before the committees of Congress[10] complaining of two modifications of the Treasury's prior prac-

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[7] Revenue Act of 1934, Section 114(b)(4), c. 277, 48 Stat. 680.

[8] Revenue Act of 1936, Section 114(b)(4), c. 690, 49 Stat. 1648.

[9] Revenue Act of 1938, Section 114(b)(4), c. 289, 52 Stat. 447.

[10] House Hearings, 1942, pp. 1169–1202 (App. B, pp. 147–153); Silver Subcommittee Hearings, 1942, pp. 731–766, 812–814, 858–864, 999–1039 (App. B, pp. 154–191); Senate Hearings, 1942, pp. 969–973, 1311–1323 (App. B, pp. 192–195).

tice which had allegedly occurred in the late 1930's and in 1940.

The first grievance was that the Treasury had begun to exclude from the gross income computation certain processes, such as the furnacing of quicksilver ores and the cyanidation of gold, which the mining industry believed to be the equivalent of beneficiation processes allowed under the 1932 Regulations. It was stated that quicksilver could not be marketed without furnacing it,[11] and it was urged that the cyanidation of gold was a process which the Treasury had previously considered equivalent to concentration (a specifically allowed process).[12] In support of this claim that the Treasury was disallowing processes which were a part of the necessary preparation of the mineral for market, reference was made[13] to the Parker and Shepherd Reports to show the guiding purpose with which Congress had acted in 1932. No suggestion was made that the gross income from the property should be computed on the basis of advanced or manufactured products. On the contrary, a principal industry witness at one of the hearings stated[14]—

> Obviously it was not the intent of Congress that those processes which would take your products and make them into different products having very different uses should be considered, as the basis of depletion.

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[11] House Hearings, 1942, p. 1199 (App. B, p. 152).

[12] Silver Subcommittee Hearings, 1942, pp. 813, 861, 1010 (App. B, pp. 170–171, 177, 188–189).

[13] House Hearings, 1942, p. 1170 (App. B, p. 148).

[14] Silver Subcommittee Hearings, 1942, p. 764 (App. B, p. 166).

The mining industry's other complaint [15] was that Treasury Regulations had been amended in 1940 [16] so as to require the exclusion of *profits,* as well as the *costs,* attributable to advanced processing.[17] The 1940 regulations in question had adopted the so-called "proportionate profits" test (a test which is still provided for in Treasury Regulations [18]). It provides in substance that if a taxpayer uses processes which go beyond ordinary treatment processes and there is no representative market or field price for the basic mineral product of like kind and grade, there shall be an allocation as between the costs and profits attributable to ordinary treatment processes and those attributable to further processing, the former to constitute the "gross income from the property."

Congress passed the 1942 Act without taking action on either of the complaints, although, by that statute, it added fluorspar, rock asphalt and ball and sagger clay to the minerals entitled to the depletion allowance.[19] During Senate consideration of the bill, how-

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[15] See Silver Subcommittee Hearings, 1942, p. 1008 (App. B, p. 186).

[16] T.D. 4960, approved January 3, 1940 (1940–1 Cum. Bull. 38), amending Treasury Regulations 101, which had been made applicable to the Internal Revenue Code of 1939 by T.D. 4885 (1939–1 Cum. Bull. (Part 1) 396). This was continued in Treasury Regulations 103 (1940 ed.), Sec. 19.23(m)–1, promulgated under the Internal Revenue Code of 1939 (App. B, pp. 142–147).

[17] Silver Subcommittee Hearings, 1942, p. 1010 (App. B, pp. 188–189).

[18] See Treasury Regulations 111, Sec. 29.23(m)–1, App. A, *infra,* pp. 95–96.

[19] Revenue Act of 1942, Section 145(a), c. 619, 56 Stat. 798 (App. B, p. 198).

ever, there was a discussion between Senator Johnson of Colorado and Senator Thomas of Idaho as to the industry complaints. Senator Johnson reported that the Treasury had agreed to modify its practice with respect to disallowing equivalent processes, but would continue to exclude profits as well as costs attributable to excluded processes. This colloquy confirmed that it had been the original intent of Congress in 1932 that "the ordinary treatment processes which a mine operator would normally apply in order to obtain a suitable product should be considered as part of the mining operation." [20]

In 1943, the House added certain critical minerals to the statute, allowing them percentage depletion on a temporary basis.[21] The Senate Finance Committee held hearings on the House bill, and several industry representatives appeared in support of an amendment introduced by Senator Johnson dealing with the problems discussed in 1942.[22] This amendment, which was later enacted in part, dealt with both of the grievances discussed earlier. It provided that mining should extend to "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product," and it specified, in conformity with the 1932 Treasury Regulations, what these processes would be for certain

[20] Senate Debate, 1942, 88 Cong. Record (Part 6), p. 8033 (App. B, pp. 196–198).

[21] See H. Rep. No. 871, 78th Cong., 1st Sess. (App. B, pp. 199–200).

[22] Senate Hearings, 1943, pp. 527–529, 785–786, 926–928 (App. B, pp. 201–209).

classes of mines.[23] The proposed amendment also contained a provision (not enacted) that only the costs of any process or service which does not constitute an "ordinary treatment process" shall be excluded in computing the gross income from the property.[24]

The American Mining Congress supported the Johnson amendment as a proper interpretation of the original intent of Congress and the administrative practice under the 1932 Regulations, stating:[25]

> The proposed amendment simply incorporates in the law the practices established by the Bureau under the 1932 regulations, and does not modify the existing regulations in any essential way except to limit the deductions in calculating gross income to the costs of the processes or services subsequent to those which are regarded as ordinary treatment processes and specified as such.

The Senate Finance Committee adopted this amendment, declaring:[26]

> The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, and

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[23] This portion of the amendment became law and is the definition of "mining" to be construed in the present case.

[24] The text of the Johnson amendment is set forth in the Senate Hearings, 1943, p. 529 (App. B, pp. 205–207).

[25] Statement of Donald H. McLaughlin, representing the Tax Committee of the American Mining Congress, Senate Hearings, 1943, p. 528 (App. B, p. 204).

[26] S. Rep. No. 627, 78th Cong., 1st Sess. (App. B, pp. 210–211).

> to give reasonable specification of what are to be considered such processes for various kinds or classes of mines. * * *
>
> * * * The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the Bureau practices and procedures thereunder. It is therefore made retroactive to the date of such original provisions.

The Senate adopted the Johnson amendment without significant change and the bill went to conference. There, the House receded with two amendments.[27] The first deleted the Senate provision which would have allowed the inclusion in the depletion base of profits attributable to advanced processing. The second made express provision for excluding certain processes, *i.e.*, electrolytic deposition, roasting, thermal or electric smelting and refining, from the classification "ordinary treatment processes." As so amended, the bill passed.

It thus appears that Congress, in 1943, approved and codified the original regulations and practice whereby "gross income from the property" had been restricted to gross income obtained (or obtainable) from sale of the basic mineral product of the particular mining industry. In doing so, Congress made the statute retroactive to 1932. It is especially notable (1) that Congress, in defining and in listing (for designated minerals) "ordinary treatment processes,"

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[27] H. Conference Rep. No. 1079, 78th Cong., 2d Sess., pp. 20–21, 50–51 (App. B, pp. 219–222).

did so on a class or industry basis, not on a taxpayer-by-taxpayer basis; and (2) that Congress specifically refused to modify the proportionate profits computation, a computation which is made under Treasury Regulations *only* where a taxpayer markets a finished product and there is no representative market price for the basic mineral product.

5. *Since the enactment of the statutory definition in 1943, Congress has consistently interpreted the statutory standard in accordance with the guiding purposes expressed in 1932 and 1943.*

Although, since 1943, Congress has repeatedly considered proposals to modify the definitive criteria of the statute, the only change adopted was in 1950 when transportation of the mineral from the point of extraction to the place where the ordinary treatment processes are applied was expressly included in the definition of mining.[28] This provision apart, there is no indication that Congress has desired, in any way, to broaden the scope of mining, much less to abandon the settled distinction between mining and manufacturing. The evidence is to the contrary.

The next congressional consideration of the depletion allowance was in 1947 when the temporary wartime allowance for certain non-metallic minerals was made permanent and the allowance was extended to certain competitive minerals.[29] In seeking this legislation, the industry representatives requested the allowance on the same basis as oil and gas and other

[28] Revenue Act of 1950, Section 207, c. 994, 64 Stat. 906 (App. B, p. 287).

[29] Act of August 8, 1947, c. 515, 61 Stat. 917 (App. B, pp. 240-241).

minerals; the hearings,[30] the committee reports [31] and the debates [32] make it clear that the purpose of the allowance and the method of computation were to remain unchanged. The 1947 Act continued the existing standard;[33] it may also be viewed as a further legislative ratification of the outstanding regulations, which had been slightly modified after the 1943 Act.[34]

During House Hearings on Revenue Revisions, 1947–1948,[35] the American Mining Congress proposed that a definition of "*net* income from the property" (italics supplied) be added to the Code, allegedly because the Treasury practice had again strayed from "the original intent of these provisions or from the Bureau's practice of earlier years." Although the Ways and Means Committee took no action, the proposal itself indicates that the industry was not challenging the definition of *gross* income from the property.

In 1949, in connection with its consideration of the Technical Changes Act of 1949,[36] the Senate passed an

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[30] House Hearings, 1947 (App. B, pp. 241–245).

[31] H. Rep. No. 802, 80th Cong., 1st Sess. (1947–2 Cum. Bull. 353), pp. 2, 9 (App. B, pp. 235–236); S. Rep. No. 693, 80th Cong., 1st Sess. (1947–2 Cum. Bull. 359) (App. B, p. 238).

[32] House Debate, 1947, 93 Cong. Rec. (Part 8), pp. 9626–9628 (App. B, pp. 236–237).

[33] The Senate added an amendment specifying the ordinary treatment processes for potash and thenardite, which was stricken at conference, leaving the matter to be determined under existing law. H. Conf. Rep. No. 1097, 80th Cong., 1st Sess., p. 3 (1947–2 Cum. Bull. 360) (App. B, p. 239).

[34] Treasury Regulations 111, as amended by T.D. 5413, approved October 31, 1944 (1944 Cum. Bull. 124), Section 29.23(m)–1(f) (App. B, pp. 226–229).

[35] App. B, pp. 243–245.

[36] Act of October 25, 1949, c. 720, 63 Stat. 891.

amendment which would have extended percentage depletion to a number of named minerals and to "all other nonmetallic clays and minerals." [37] Although this was dropped in conference, with the understanding that the matter would be taken up the following year, it is significant that a broad extension of the allowance to numerous additional minerals was not thought to require any modification of the method of computing the allowance. In fact, the Senate Finance Committee Report stated: [38]

> It is not proposed to allow percentage depletion with respect to the value added as the result of grinding or other special preparation because many of the extractors do not themselves carry on this process, but rather sell these minerals in crude form and let others carry on any processing required. Thus to allow percentage depletion with respect to this added value would discriminate against those selling these minerals in crude form, since percentage depletion is not allowable to processors.

In 1950, the House considered the requested extension of the allowance to additional minerals as promised by the House conferees in 1949. After extensive hearings,[39] the Ways and Means Committee proposed extension of the allowance to a number of minerals because they were "competitive with the minerals receiving percentage depletion or have just as good a

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[37] The text of this amendment is summarized in H. Conf. Rep. No. 1412, 81st Cong., 1st Sess., p. 11 (App. B, p. 248).

[38] S. Rep. No. 831, 81st Cong., 1st Sess., p. 10 (App. B. p. 247).

[39] House Hearings, 1950 (App. B, pp. 249–264).

claim for such treatment as the enumerated minerals."[40] The Committee also proposed[41] the adoption of a Treasury recommendation on allowable transportation—

> * * * In order to restrict depletion to the actual product of mineral extraction, it is stipulated in your committee's bill that the gross income to which the percentage depletion rate is to be applied shall not include income resulting from the transportation of the product beyond the property.

During House debates, objection was made to the transportation exclusion as being too restrictive where it applied to transportation before the product was rendered marketable, but the Committee bill was approved.[42] At the Senate Finance Committee hearings on the House bill, industry representatives complained of this provision, urging that it be amended to allow transportation to the place where "ordinary treatment processes were applied," since the ordinary treatment processes determined what was and was not mining under the statute.[43] The representations of the industry were again couched in terms of the existing standard of what constituted gross income from the property. In speaking of the existing interpreta-

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[40] H. Rep. No. 2319, 81st Cong., 2d Sess., p. 64 (App. B, p. 265).

[41] *Id.*, p. 65 (App. B, p. 266).

[42] House Debate, 1950, 96 Cong. Rec. (Part 7), pp. 9282–9283 (App. B, pp. 266–269).

[43] Senate Hearings, 1950, pp. 301–302, 447–449, 771–785 (App. B, pp. 269–281).

tion, the American Mining Congress representative explained: "

> * * * Transportation necessary to move the minerals to the plants where the ordinary treatment processes were performed was, like the processes themselves, to be considered as a part of mining. Transportation from the place where the last of the specified processes was applied was not to be considered as part of mining; nor were any further processes beyond those specified. * *The processes specified gave the cut-off point between what was and what was not to be considered mining in each case.*
>
> We are confident that Congress, in adopting the 1943 amendment to express the intent of the prior law, intended that the definition of "gross income" written into the law should carry the same meaning and *the same cut-off point* with regard to transportation as had been set forth in the early regulations and had been followed in Bureau procedure. [Italics supplied.]

The Senate adopted this view and amended the House bill accordingly.[45] In conference, the House receded with an amendment limiting transportation to 50 miles, unless the Secretary approved a greater distance.[46] On this basis, the transportation provision

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[44] Statement of Henry B. Fernald, Chairman, Tax Committee, American Mining Congress, Senate Hearings 1950, p. 771 (App. B, p. 275).

[45] S. Rep. 2375, 81st Cong., 2d Sess., pp. 52–53 (App. B, pp. 282–283).

[46] H. Conf. Rep. No. 3124, 81st Cong., 2d Sess., p. 26 (App. B, pp. 284–285).

was enacted. The Senate again postponed the extension of the depletion allowance to additional minerals.

The Revenue Act of 1951[47] contains the last amendment of the percentage depletion provisions of the 1939 Code. This Act merely extended the allowance to a number of minerals, including fire clay and shale, at varying rates of depletion; it did not modify the method of determining the base to which these rates were to be applied. It is again significant that the extension of the allowance was requested on the basis of the *first* marketable product in the *industry*, and not by reference to a particular taxpayer's marketed product.[48]

The chronological account of the legislative history ends with the congressional deliberations preceding the adoption of the Internal Revenue Code of 1954. Although the pertinent provision of that Code is not in issue here, it is to be observed that the basic definition of mining remains the same in the 1954 Code.[49]

B. Controlling Propositions Established by the Legislative History

In the preceding section, we have recounted chronologically the development of percentage depletion.

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[47] Revenue Act of 1951, Section 319, c. 521, 65 Stat. 452 (App. B, 307–308).

[48] See discussion *infra*, pp. 78–80.

[49] Internal Revenue Code of 1954, Section 613. See H. Rep. No. 1337, 83d Cong., 2d Sess., p. 58, A185 (App. B, pp. 312–314); S. Rep. No. 1622, 83d Cong., 2d Sess., p. 79, 332 (App. B, pp. 314–316); H. Conf. Rep. No. 2543, 83d Cong., 2d Sess., pp. 52–53 (App. B, p. 316).

The main themes which run through the lengthy course of the congressional deliberations are evident. Nonetheless, it may be useful to formulate those propositions, important for present purposes, which emerge from that history and to restate briefly what we consider to be the compelling items of proof.

1. *Congress proposed to avoid economic discrimination, particularly against the small miner.*

Under the decision below, an integrated sewer-pipe manufacturer takes depletion for fire clay and shale on the basis of the gross income received from the sale of manufactured sewer pipe, realizing an allowance of $4.03 per ton (almost three times the market price which those minerals command). A non-integrated miner of the same minerals obtains a depletion allowance of approximately fifteen cents per ton.[30] Yet the legislative history establishes, in our view, that Congress proposed to put all miners, large and small, on an equal footing.

The percentage method of measuring depletion allowance was devised and justified as a means of eliminating discrimination as between various segments of the mining industry and as between miners in each group or class. The industry has repeatedly urged it as a fair and equitable method of measuring the exhaustion of capital assets. And the allowance has been progressively extended to new minerals on the basis of representations that it was necessary to do so in order to eliminate competitive injuries suffered

[30] Competing manufacturers (who receive no subsidy), and miner-manufacturers (those, for example, who have low-cost mines) are subject to similar prejudice.

by those classes of mines which did not enjoy the privilege.

We note the following items:

Percentage depletion for the oil and gas industry was urged and enacted (in 1926) primarily on the ground that it would eliminate discrimination against small producers which had resulted from the burdens involved in establishing discovery value.[51]

Coal, sulphur and metal mine representatives sought depletion for their respective industries because it "removes the discrimination against the large number of smaller taxpayers who do not have the technical staffs or who feel unwarranted in going to the expense of engaging the professional services necessary to the establishment of discovery depletion"; because, under percentage depletion, "the small operator would in practice as well as in theory receive the same treatment as the large corporation"; and because the adoption of percentage depletion "would also remove the discrimination now existing against the mining industry as compared with the oil and gas industry."[52]

[51] See Senate Hearings, 1926, p. 177 (App. B, p. 19); see, also, Partial Report of the Select Committee on Investigation of the Bureau of Internal Revenue, p. 116 (App. B, p. 15).

[52] House Hearings, 1927–1928, pp. 506, 511 (App. B, pp. 38, 46). There are many other statements of like tenor. See Parker Report (Joint Committee Report, 1930, pp. 2, 12 (App. B, pp. 70, 72)); Shepherd Report (Joint Committee Report, 1930, p. 63 (App. B, pp. 76–77)); Joint Committee Hearings, 1930, pp. 30–34, 94–95 (App. B, pp. 97–98, 104–105); House Hearings, 1932, pp. 327–328, 329, 342–343 (App. B, pp. 108–109, 110, 118–119); Senate Hearings, 1932, pp. 229–230, 231–232 (App. B, pp. 125–127); House Hearings, 1934, p. 393 (App. B, p. 140); House Hearings, 1942, pp. 1184–1185 (App. B, pp. 150–151); House Hearings, 1951, pp. 1573, 1582 (App. B, pp. 292, 295).

The successive extensions of percentage depletion to other minerals, beginning in 1942, was similarly urged and adopted on the ground that such minerals were competitive with minerals which had been already accorded percentage depletion.[53] Thus, fire clay, one of the minerals involved in this case, was accorded percentage depletion in 1951 only after industry representatives testified that it was competitive with other types of clay which had been granted the privilege.[54]

2. Congress proposed to avoid discrimination by establishing a uniform standard for determining, in relation to each class of mine, the scope of "mining."

In support of this proposition, we stress the following:

In 1913, Congress limited depletion to 5 percent of the value of the mineral product at the mouth of the mine. The implementing Treasury Regulations required that, when the mineral was sold elsewhere, the

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[53] See, generally, H. Rep. No. 2333, 77th Cong., 2d Sess., p. 92 (App. B, pp. 153–154); S. Rep. No. 1631, 77th Cong., 2d Sess., p. 115 (App. B, p. 195); H. Rep. No. 802, 80th Cong., 1st Sess., p. 9 (App. B, pp. 234–236); H. Rep. No. 586, 82d Cong., 1st Sess., pp. 29, 114 (App. B, pp. 296–298); S. Rep. No. 781, 82d Cong., 1st Sess., pp. 37–38 (App. B, pp. 299–302). See, also, the material in Appendix B, Part II, in connection with the following minerals: asbestos, bentonite, borax, fire and refractory clay, quartzite, diatomaceous earth, fuller's earth, stone, chemical and metallurgical grade limestone, perlite, rock asphalt, slate, trona, vermiculite, and wollastonite (App. B, pp. 316–318, 320–326, 335–342, 348–349, 352–353, 363–394, 395–396, 407–413, 423–432, 454–466). Competitive reasons for the extension of percentage depletion were offered in each instance.

[54] The testimony was that fire clay competes with sagger clay, bauxite, china clay, ball clay, bentonite, vermiculite. House Hearings, 1950, p. 453 (App. B, pp. 338–339).

costs of processing beyond the mine and of transportation should be excluded.[55]

In 1922, the Treasury ruled that gross income for an integrated operation was to be determined by "the market or field price of the raw material before conversion."[56] With full Congressional approval, the same principle was later applied by the Treasury in administering percentage depletion in the oil and gas industry.[57]

The crucial 1932 Treasury Regulations, relating to metal mines, coal and sulphur, undertook once again to restrict producers to the ordinary treatment processes of mineral production and to preclude the possibility that advanced or different processing, such as that performed by integrated producers, might serve as a basis for enhanced depletion. Thus, integrated operators were required to adopt the representative market price of the basic mineral product or, if there were none, to exclude the advanced processes from the computation.[58]

In 1943, Congress codified and adopted the essential features of the 1932 Treasury Regulations. It

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[55] Income Tax Act of 1913, Section IIB, c. 16, 38 Stat. 114, 166 (App. B, p. 1); Treasury Regulations 33 (1914 ed.), Art. 142 (App. B, pp. 1–2).

[56] Treasury Regulations 62 (1922 ed.), Art. 201(h) (App. B, p. 6).

[57] Treasury Regulations 74 (1929 ed.), Art. 221(i) (App. B, p. 64); Senate Debate, 1926, p. 3762 (App. B, p. 27); Joint Committee Report on Depletion, 1927, pp. 11–14 (App. B, pp. 32–34); see also, S. Rep. No. 52, 69th Cong., 1st Sess., pp. 17–18 (App. B, pp. 25–26); H. Conference Rep. No. 356, 69th Cong., 1st Sess., p. 31 (App. B, p. 29).

[58] Treasury Regulations 77, Art. 221(g) (App. B, pp. 135–137).

allowed only "ordinary treatment processes." In the case of certain minerals, it listed those processes. It excluded other processes, *e.g.*, smelting and refining, by name. Also, it refused to override the proportionate profits computation (provided for in 1940 Treasury Regulations) [59]—a computation which is designed solely for the situation where a taxpayer markets a different product and there is no representative market price for the basic mineral product.[60]

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[59] For a discussion of the proportionate profits computation, see *Alabama By-Products Corporation* v. *Patterson*, 258 F. 2d 892 (C.A. 5th), certiorari denied, 358 U.S. 930.

[60] Revenue Act of 1943, c. 63, 58 Stat. 21 (App. B, pp. 223–225); S. Rep. No. 627, 78th Cong., 1st Sess., pp. 23–24, 55 (App. B, pp. 210–211; 212–213); H. Conference Rep. No. 1079, 78th Cong., 2d Sess., pp. 20–21, 51 (App. B, pp. 219–220, 222).

For complaints leading up to passage of the statute, see the following: Silver Subcommittee Hearings, 1942, pp. 863–864, 1002–1010 (App. B, pp. 182–190); Silver Subcommittee Recommendations, p. 1039 (App. B, p. 192); Senate Hearings, 1943, pp. 527–529, 927 (App. B, pp. 201–207, 209).

For statements showing that the statute was a codification of the 1932 Treasury Regulations and indicating approval of the proportionate profits test contained in the 1940 Treasury Regulations, see the following: Senate Debate, 1942, p. 8033 (App. B, pp. 196–198); Senate Hearings, 1943, pp. 528, 927 (App. B, pp. 204, 209); House Hearings, 1947, pp. 1857–1858 (App. B, pp. 242–244); House Hearings, 1950, pp. 349, 355–356 (App. B, pp. 253, 255–257); Senate Hearings, 1950, pp. 771, 782 (App. B, pp. 275, 280); S. Rep. No. 2375, 81st Cong., 2d Sess., p. 52 (App. B, p. 282); House Hearings, 1951, pp. 1571–1573 (App. B, pp. 290–292); see, also, Dickinson, *Depletion—Gross Income—The Property*, 18–19 Mining Congress Journal (1932–1933), October 1932 issue, p. 9 (App. B, pp. 466–468); Dickinson, *Wheels of Government*, 28 Mining Congress Journal (1942), November 1942 issue, p. 50 (App. B, pp. 469–470); *Secretary's Report, American Mining Congress Reviews Its Activities in 1942*, 29.2 Mining Congress Journal, Mar.–Dec.

In the entire legislative history, extending for more than forty years, the only proposal that taxpayers be allowed to proceed on an individual, rather than an industry-wide, basis was a suggestion that certain types of metal miners be authorized to compute depletion on the basis of the crude, partially beneficiated or refined metals, depending on the actual method of disposition.[81] This proposal was rejected. At every stage of the history, it has been recognized that there must be a cut-off point, for each segment of the mining industry, which will separate the mining from the non-mining activities.[82]

1943), March 1943 issue, p. 21 (App. B, pp. 471–472); Dickinson, *Wheels of Government*, 29.2 Mining Congress Journal (Mar.–Dec. 1943), December 1943 issue, p. 54 (App. B, p. 472); Dickinson, *Wheels of Government*, 30 Mining Congress Journal (1944), January 1944 issue, p. 52 (App. B, pp. 474–476); Dickinson, *Wheels of Government*, 30 Mining Congress Journal (1944), February 1944 issue, pp. 115–116 (App. B, pp. 476–477, 478–479); Kent, *The New Idria Decision*, 30 Mining Congress Journal (1944), November 1944 issue, p. 21 (App. B, pp. 479–481); Dickinson, *Wheels of Government*, 30 Mining Congress Journal (1944), November 1944 issue, pp. 52–53 (App. B, pp. 482–483); Fernald, *Depletion and Related Problems under the Revenue Act of 1942*, 21 Taxes, The Tax Magazine, 141, 143 (1943) (App. B, 483–486).

[81] Shepherd Report, p. 71 (App. B, p. 87).

[82] Partial Report of the Select Committee on Investigation of the Bureau of Internal Revenue, 1926, p. 55 (App. B, pp. 13–14); Joint Committee Report on Depletion, 1927, pp. 11, 13 (App. B, pp. 32, 33); Senate Hearings, 1928, p. 317 (App. B, p. 60); Joint Committee Report, 1930, Appendix XXXI (Shepherd Report), pp. 64, 68–71 (App. B, pp. 78, 82–87); Joint Committee Hearings, 1930, pp. 57, 110–111 (App. B, pp. 101–102, 105); House Hearings, 1932, pp. 331, 338–340, 345 (App. B, pp. 111, 114–116, 120); House Hearings, 1942, pp. 1199, 1202 (App. B, pp. 151–153); Silver Subcommittee Hearings, 1942, pp. 762–763, 860, 863–864, 1002, 1009–1010 (App. B, pp. 160–163,

3. The concept of "ordinary treatment processes," as the mining industry repeatedly represented and as Congress well understood, establishes an ascertainable cut-off point: Mining includes only such customary mineral treatment as is necessary in the particular branch of the mining industry in order to obtain, in marketable form, the basic mineral product.

Perhaps the most significant aspect of the legislative history, from the standpoint of the issues presented by this case, is that the mining industry itself has consistently taken the position before the Congress that it was seeking depletion on a basis which would not extend beyond the point where the mineral is made fit for commercial or industrial use.

So far as oil and gas depletion is concerned, it has always been assumed or acknowledged that the market or field price before conversion fixes the cut-off point. See *supra,* pp. 42–46. The Treasury Regulations have so provided. *Ibid.*

When the metal miners sought percentage depletion, the American Mining Congress advised that this method would provide an "approximation of the present worth * * * of ore in place,"[48] and that the includible mining processes would be those "cus-

175–176, 181–184, 186–190); Senate Hearings, 1942, p. 1322 (App. B, p. 193); S. Rep. No. 627, 78th Cong., 1st Sess., pp. 23–24 (App. B, pp. 210–211); H. Conference Rep. No. 1079, 78th Cong., 2d Sess., p. 50 (App. B, p. 222); Housing Hearing, 1947, p. 11 (App. B, p. 231); S. Rep. No. 831, 81st Cong., 1st Sess., p. 10 (App. B, p. 247); House Hearings, 1950, pp. 282, 379, 382, 414 (App. B, pp. 250, 257, 260); House Debate, 1950, p. 9282 (App. B, p. 266); H. Rep. No. 2319, 81st Cong., 1st Sess., p. 65 (App. B, p. 266); Senate Hearings, 1950, pp. 301–302, 771, 782 (App. B, pp. 270–272, 275, 279); S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 52–53 (App. B, p. 282); House Hearings, 1953, pp. 1986–1987 (App. B, p. 309).

[48] Senate Hearings, 1928, p. 308 (App. B, p. 57).

tomary within each division [of the metal mining industry] in disposing of ores, concentrates, or metals."[64] Congress observed that the integrated operator could readily compute depletion on the same basis ("net smelter return") as "the smaller operator who sells to a smelter."[65] The American Mining Congress has endorsed this position as correct.[66] As late as 1951, it stated that the test adopted was "the gross values of the ore produced" and that this test eliminated "discriminations as between individual producers of the same metal."[67]

Sulphur and coal were granted percentage depletion in 1932 along with the metal mines. The sulphur representative advised Congress that there would be no problem, as in the case of metals, in "allocating the proper portion of the income between that which was due to the mining operations simpliciter and that which was due to smelting, refining, transporting, etc."[68] Coal representatives never suggested that a more advanced product (*e.g.*, coke) could serve as a basis for depletion, although they pointed out that the coal industry was depressed and that many producers were not making a profit on their coal operations.[69] Moreover, the statute itself specifies the "ordinary treatment processes" for coal (cleaning, breaking, sizing and loading for shipment)—all of them processes

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[64] *Id.* at p. 317 (App. B, p. 60).

[65] Shepherd Report, p. 70 (App. B, p. 84).

[66] House Hearings, 1942, p. 1170 (App. B, p. 148).

[67] House Hearings, 1951, pp. 1572–1573 (App. B, p. 292).

[68] House Hearings, 1932, p. 340 (App. B, pp. 439–440).

[69] House Hearings, 1932, p. 345 (App. B, pp. 120–121). And see Senate Hearings, 1954, p. 1409 (App. B, p. 343).

applied at the mine to prepare coal for industrial or commercial use.

Our chronological review of the legislative history (Point II A, *supra*) discussed principally those minerals granted percentage depletion in the earlier years when the statutory provisions and the Treasury Regulations crystallized. However, in the 1940's and early 1950's, percentage depletion was extended to more than thirty additional minerals. All of these mining industries sought depletion on the same basis that it had been previously accorded. Testimony of their various representatives is set out at length in Appendix B, pp. 316–466. And see "Chart of Products in relation to which Various Branches of Mining Industry Sought Percentage Depletion" (App. B, p. 502). We stress that none of the industry representatives suggested that percentage depletion might be measured by reference to the sale of fabricated products. To the extent that it was suggested that depletion would include processing beyond extraction, it was on the basis that particular processes were ordinary and customary processes which were required to put the mineral in a state fit for industrial or commercial use.

For example:

The representative of the bentonite industry advised that "trucking bentonite to the processing plants where it must be dried, granulated, or ground, is a vital portion of the processing steps necessary to develop it to its 'first commercially marketable product'

stage; that is, in dried, ground, or granulated form and packed in bags." [70]

Processes such as washing, screening and grading, it was stated, are necessary to put sand and gravel in a marketable state." [71]

Percentage depletion on borax would be computed on the basis of the "crude or unrefined commercially marketable product derived from the application of various ordinary treatment processes." [72]

Crushing and grinding to consumer specification is essential in preparing talc for the market since it has no utility until it is finely ground." [73]

Vermiculite is sold "in its crude or concentrated form" to processors who "fabricate many different types of materials, all of which are sold through dealers." [74] "Since the depletion allowance relates only to miners, it is at once apparent that the taxes to be paid by processors and dealers would in no way be affected." [75]

The representative of the refractories industry—which consists of integrated producers who mine fire clay and certain other minerals and manufacture various products therefrom—did not request depletion measured by the value of finished products; [76] instead,

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[70] Senate Hearings, 1950, p. 448 (App. B, p. 323).

[71] *Id.* at p. 794 (App. B, p. 415).

[72] House Hearings, 1950, p. 2887 (App. B, p. 325).

[73] Senate Hearings, 1950, p. 791 (App. B, p. 446); House Hearings, 1953, pp. 2035–2037 (App. B, pp. 448–449).

[74] House Hearings, 1951, p. 1615 (App. B, p. 463).

[75] *Ibid.*

[76] See House Hearings, 1950, pp. 441–464 (App. B, pp. 335–341).

he submitted a list of some 67 manufacturers of refractory products who would be entitled to percentage depletion on the "value" of "raw materials used."[77]

A representative of the vitrified clay sewer pipe manufacturers of the United States also appeared before Congress to support a request that the depletion allowance on shale be raised from five per cent to fifteen per cent. He stated that the industry *manufactures* sewer pipe from fire clay and shale and that "present law provides percentage depletion rates for clays and shales *used* in the *manufacture* of sewer pipe." [Italics supplied.][78] He argued further that the "type of shales *usable* in the production of sewer pipe are at least as scarce and as difficult to locate as fire clays, for which a 15-percent depletion rate is provided." [Italics supplied.][79]

III

AS APPLIED TO THE FACTS OF THIS CASE, THE STATUTORY DEFINITION OF "MINING" REQUIRES THE CONCLUSION THAT TAXPAYER'S DEPLETION ALLOWANCE MUST BE COMPUTED WITH REFERENCE TO THE CRUDE MINERALS (RAW FIRE CLAY AND SHALE).

To this point, our argument has been directed to showing that the statutory definition of "mining" prescribes an ascertainable and uniform standard for determining the scope of mining in relation to each mineral, and that mining extends only so far as to include the minimum treatment or preparation which is necessary to make the mineral fit for commercial or industrial use. On this view, it is immaterial what

[77] *Id.* at pp. 455–456 (App. B, pp. 339–340).
[78] House Hearings, 1953, p. 2099 (App. B, pp. 416–417).
[79] *Ibid.*

end products a particular integrated miner-manufacturer elects to make or finds it profitable to make. Congress undertook to allow depletion in relation to mineral values consumed or exhausted in the process of mining, but it did not thereby undertake to guarantee miners a profit. Indeed, it was a representative of the American Mining Congress who stated, "The miner does not expect the Government to guarantee a profit to him." [80]

We turn now to an examination of the facts of this case and to the application of the principles which we urge.

A. Taxpayer mined fire clay and shale (in 60–40 proportions) from a mineral formation where shale underlay the fire clay. (R. 4, 24.)[81] The shale is also a clay, but one which contains some iron and is darker than fire clay when fired. (R. 201–204.) It is apparently indistinguishable from fire clay to the casual observer since at least one miner of both minerals could not tell them apart. (R. 174.) For depletion purposes, however, fire clay and shale must be considered separately. The two minerals are not always mined together and each is regarded as a separate branch of the mining industry. Moreover, the depletion rates for the two minerals are different, *i.e.*, fifteen per cent for fire clay and five per cent for shale.

So far as fire clay is concerned, the court below stated (R. 267, 270) that the record showed a sub-

[80] House Hearings, 1950, p. 351 (App. B, p. 253).

[81] Both are relatively inexpensive minerals for which percentage depletion was first allowed in 1951. Revenue Act of 1951, Section 319, c. 521, 65 Stat. 452 (App. B, p. 307).

stantial market in Indiana and that "large quantities" were sold in the taxable year.

Statistics of which this Court may take notice show further that there are substantial sales of fire clay on a national scale. In 1951, production of fire clay was over 11,800,000 tons, of which 3,150,000 tons were actually sold. The remainder was produced by integrated miner-manufacturers and used by them in their manufacturing establishments. Over 101,000 tons were exported, mostly to Canada. See Minerals Yearbook (1951), U.S. Bureau of Mines, Department of the Interior, pp. 293–295. Three years later, in 1954, over 4,400,000 tons were shipped by miners and, in addition, a little less than 4,000,000 tons were mined and used by integrated miner-manufacturers in establishments manufacturing clay, refractory and pottery products. 1954 Census of Mineral Industries, U.S. Department of Commerce, Bureau of the Census, pp. 14F–2 and 14F–5.[32]

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[32] We have noted above (*supra*, pp. 79–80) that the refractories industry in seeking depletion furnished a list of integrated manufacturers who used fire clay and stated that these manufacturers would be entitled to depletion on the "value" of the "raw materials used." Shortly after percentage depletion was extended to fire clay, *The Brick and Clay Record*, the leading trade journal in the clay industry, stated (issue of Jan. 1952, p. 25 (App. B, p. 487)) "that there is an established market and regular commerce in fire clay." Later, in 1953, a representative of the Refractories Institute suggested to the Ways and Means Committee that "ordinary treatment processes" should be deemed to include "crushing, grinding, screening and blending." House Hearings, 1953, p. 2072 (App. B, p. 342). This suggestion also falls far short of taxpayer's present contention.

The Court of Appeals also stated that the record showed significant Indiana sales of shale. (R. 267, 270). It noted in this connection that there were "two producers of shale in Indiana engaged in nonintegrated operations." (R. 270.)[23]

Official statistics also indicate national sales of shale, although in considerably less quantity than in the case of fire clay. In 1951, over 27,600,000 tons of "Miscellaneous Clays," including shale but excluding fire clay and other classified clays, were sold or used in the United States; of this, approximately 990,000 tons were actually sold. Minerals Yearbook (1951), U.S. Bureau of Mines, Department of the Interior, p. 300. Three years later, in 1954, there were net shipments of almost 30,000,000 tons of "common clay and shale" (excluding fire clay and other classified clays), including that produced and used by integrated operators having manufacturing establishments; over 3,800,000 tons of that amount were shipped by miners not having manufacturing establishments. 1954 Census of Mineral Industries, U.S. Department of Commerce, Bureau of the Census, pp. 14F–2, 14F–3, 14F–10.

The court below, having found substantial sales of both minerals, stated (R. 269) that the instant case was different from a prior group of cases lost by the Commissioner because in those cases the Government had "admitted that each taxpayer had no market, or

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[23] It also appears (R. 163–172) that a miner located in Kentucky, directly across the river from taxpayer, sold substantial quantities of both fire clay and shale to a sewer pipe manufacturer.

a market for only a negligible quantity, of the particular raw mineral involved."[84] It held against the Government, however, on the ground that this taxpayer, who had high mining and transportation costs, "could not sell [fire clay and shale] at a profit." (R. 271.)[85]

This ground, we submit, is untenable. We deal here with a tax benefit extended to miners to compensate them for the exhaustion of mineral assets. A mine does not become more valuable because the costs of operation are high or because its strategic market location is poor. An integrated operator, to be sure, may have many good economic reasons for conducting a mining operation far from the place where there is a profitable market for the mineral in question; his dominant, perhaps exclusive, interest is in the sale of *finished* products. For his *mineral* product, he sup-

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[84] *United States* v. *Cherokee Brick & Tile Co.*, 218 F. 2d 424 (C.A. 5th); *Townsend* v. *Hitchcock Corp.*, 232 F. 2d 444 (C.A. 4th); *United States* v. *Sapulpa Brick & Tile Co.*, 239 F. 2d 694 (C.A. 10th); *United States* v. *Merry Brothers Brick and Tile Co.*, 242 F. 2d 708 (C.A. 5th), certiorari denied, 355 U.S. 824; *Dragon Cement Co.* v. *United States*, 244 F. 2d 513 (C.A. 1st), certiorari denied, 355 U.S. 833.

[85] Although the court found that the minerals involved in this case were sold in raw form in substantial quantities, it made no mention of Section 114(b)(4)(B), subparagraph iii (App. A, *infra*, p. 94), which states that ordinary treatment processes shall include "in the case of * * * minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating and sintering to bring to shipping grade and form, and loading for shipment." Obviously, the processes sought by taxpayer here are not of the same order as those which are involved in bringing crude minerals to "shipping grade and form."

plies his own market. These considerations can hardly warrant the conclusion that he is entitled to include in his depletion base processes which a non-integrated miner would have no occasion to utilize. Congress, as we have stressed in Points I and II, undertook to treat miners as a class; to treat them uniformly—whether large or small, integrated or non-integrated; to restrict all of them to the ordinary treatment processes normally used by miners, *qua* miners; and to establish as a cut-off point the basic mineral product yielded by an application of the normal and necessary processes. Sales are significant for purposes of applying the statute not because an ability to sell profitably is relevant, but only because sales may provide conclusive proof that a mineral product has reached a state where it is fit for commercial or industrial use—proof, in other words, that the mineral has passed beyond the point where it can be said to be undergoing the ordinary processes of "mining."

If the words "commercially marketable mineral product" stood alone in the statute and one ignored the purpose, history and related language, there might be some basis for suggesting that "commercially marketable" means "marketable by the individual seller at a profit" (though, certainly, it would be at least equally arguable that "commercially marketable" means simply that there is a market to impose a profit *or* a loss). In all events, the words do not stand alone. The statutory authorization is that the miner may include "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral

product"—in other words, the product fit for sale or commercial use. See *New Idria Quicksilver Mining Co.* v. *Commissioner,* 144 F. 2d 918, 920 (C.A. 9th); cf. *Barber Asphalt Paving Co.* v. *Standard Asphalt & Rubber Co.,* 30 F. 2d 281, 284 (C.A. 7th)."[56]

Certainly, if there are miners who in fact do nothing more than extract and sell fire clay and shale, mining cannot be said to comprehend the fabrication which is involved in converting fire clay and shale into new finished products such as sewer pipe.[57] Could it be seriously contended, for example, if United States Steel and other principal steel makers and fabricators should, one day, obtain all the ore which they utilize from mines of which they have acquired ownership, that all of the processes used in making steel and steel products would become ordinary mineral treatment processes? As we stressed under Point I, mineral treatment or mineral dressing has a settled meaning in the mining industry; it refers to those processes which are necessary in order to separate the valuable constituent of the natural deposit from other matter. This, we repeat, was well understood by Congress. See *supra,* pp. 49–51, 54–55, 59–63, 67–68. Witness, for example, the following colloquy between the

[56] See, also, the definitions of "marketable" and "vendible" in Webster's New International Dictionary (2d ed., 1949).

[57] It should be noted that the district court did not find that the processes used by taxpayer were normally applied by mine owners. Significantly, the court states (Fdg. 10, R. 5): "All of the processes used and applied by plaintiff to the fire clay and shale which it mined and used, were processes normally applied by mine owners or operators *who are engaged in the manufacture of vitrified clay sewer pipe and related products.*" (Italics supplied.)

Chairman of the Ways and Means Committee and Mr. Henry B. Fernald, Chairman of the Tax Committee of the American Mining Congress: [88]

> The CHAIRMAN. I would like to ask you another question, Mr. Fernald.
>
> Do you think, in defining minerals, we should be careful *to separate the value added by manufacturing?*
>
> Mr. FERNALD. I think as we speak of manufacturing, as you and I are dealing with the use of that term, I can say *"Yes; I think we should."* However, there are very many processings of these minerals which I would never think of as being manufacturing, and I do not think you would, and yet which many do argue should be excluded because it is a manufacturing process.
>
> *The ordinary treatment processes which are normally applied to bring your minerals into a marketable condition* I do not think should be talked of as manufacturing costs.
>
> The CHAIRMAN. I agree with you on that, because, for instance, they have mines up in my State where the product cannot be sold until it is ground fine enough to go into the market. [Italics supplied.]

In short, the "ordinary treatment processes" which are includible in a taxpayer's depletion base are those which are necessary for the purpose of putting the mineral into its marketable state—otherwise stated, those processes which a non-integrated miner would have to use. Since, as the Court of Appeals found (R. 267–270), raw fire clay and shale are sold in

[88] House Hearings, 1953, pp. 1986–1987 (App. B, pp. 309–310).

substantial quantities, it is clear that those minerals require no processing beyond extraction. But even if there were any doubt on this point, there can be no sound basis for the court's conclusion that depletion may be taken on sewer pipe and other finished products.

B. We consider finally taxpayer's arguments that the *Merry Brothers* line of cases (see note 84, p. 84, *supra*) supports its contentions.

As the court below pointed out, in those cases the Government assumed or admitted that the taxpayers "had no market, or a market for only a negligible quantity, of the particular raw mineral involved." (R. 269.) On that basis, those cases held (though incorrectly, we believe) that "ordinary treatment processes" include manufacturing processes which are necessary to obtain a marketable product from the mineral. But it is plain that they did not go so far as to hold that the individual taxpayer's situation—his ability to market profitably—is the test. They rest simply on the proposition that it appeared that there was no market for the minerals involved.[89] Here, the court below found to the contrary, *i.e.*, that there was a substantial market for the minerals in question.

Taxpayer argues further that there is no real factual distinction to be drawn between the prior cases

[89] *United States* v. *Cherokee Brick & Tile Co.*, *supra*, 218 F. 2d at 425; *Townsend* v. *Hitchcock Corp.*, *supra*, 232 F. 2d 444; *United States* v. *Sapulpa Brick & Tile Co.*, *supra*, 239 F. 2d at 697; *United States* v. *Merry Brothers Brick & Tile Co.*, *supra*, 242 F. 2d at 709; *Dragon Cement Co.* v. *United States*, *supra*, 244 F. 2d at 517.

and this case because in those cases (or some of them) the Government could also have shown (or did show) that there were some sales.[90] Accordingly, taxpayer reasons, the sewer pipe industry should stand on the same footing as the brick industry. The short answer is that the courts in those cases made findings contrary to those which were made in this case and that it is therefore immaterial, from the standpoint of the legal significance of the holdings in those cases, that different findings might have been made if the pleadings and the proof had been different.[91]

We do agree with taxpayer, however, that the issue decided in this case and the issue decided in the *Merry Brothers* line of cases are closely related. As we advised this Court in our petition (pp. 13–14), if the legal position urged by the Government in the earlier cases "had been accepted by the courts, the issue now presented would not have large importance, for it would have been established that in all events manufacturing processes are not includible in gross income from mining."

It is also true that the issue presented in the *Merry Brothers* group of cases has continuing importance. There are apparently a number of branches

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[90] We certainly would not dispute that the Government, in those cases, may have made concessions of fact which were unnecessary.

[91] Following the denial of certiorari in the *Merry Brothers* and *Dragon Cement* cases, *supra*, the Internal Revenue Service announced, on October 18, 1957, that it was "taking steps to dispose of pending litigation and claims involving brick and tile clay and cement rock, as required under these decisions, and to conform Treasury regulations and outstanding rulings accordingly." TIR–62, 1957 P–H, par. 76,726.

of the mining industry which, if they are not already fully integrated with manufacturing, may soon become so. Apart from other factors which may encourage integration, the decisions of the lower federal courts in relation to mineral depletion furnish a significant tax incentive.

In our view, it should make no difference whether a mining industry is non-integrated, partially integrated or fully integrated. Whatever the degree of integration, we believe that the term "ordinary treatment processes" refers to mining processes, and that the dependent clause "normally applied * * * to obtain the commercially marketable mineral product" indicates only that miners may claim processes beyond extraction to the extent that such processes are necessary to put the mineral in the condition where it is fit for commercial or industrial use. In the context of a tax allowance for "mining"—one designed to compensate for exhaustion of mineral values—there can be no sound basis for suggesting that if a branch of a mining industry becomes integrated with manufacturing, the depletion base, by that token, comes to comprehend the processes of fabrication.

As has been evident throughout our brief, our arguments as to the meaning of the statute and as to its history bear not only upon the correctness of the decision below; of necessity, they bear also upon the correctness of the approach adopted in the earlier cases decided in the courts of appeals. Inasmuch as this Court, in this case, will be estab-

lishing criteria to which the lower courts will hereafter look in interpreting the statutory definition of "mining," it is, we believe, appropriate that the Court consider the different (though related) approaches taken in the decided cases with a view to providing proper guidance for the future.

CONCLUSION

The judgment of the Court of Appeals should be reversed and the cause remanded so that taxpayer's "gross income from mining" may be determined in the light of the correct legal criteria.

Respectfully submitted.

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MARCH 1960.

APPENDIX A

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

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(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * * *

(b) *Basis for depletion.*—

* * * * * *

(4) [as amended by Sec. 145 of the Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 319(a) of the Revenue Act of 1951, c. 521, 65 Stat. 452] *Percentage depletion for coal and metal mines and for certain other mines and natural mineral deposits.*—

(A) *In general.*—The allowance for depletion under section 23(m) in the case of the following mines and other natural deposits shall be—

(i) in the case of sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, marble, sodium chloride, and, if from brine

wells, calcium chloride, magnesium chloride, and bromine, 5 per centum,

(ii) in the case of coal, asbestos, brucite, dolomite, magnesite, perlite, wollastonite, calcium carbonates, and magnesium carbonates, 10 per centum,

(iii) in the case of metal mines, aplite, bauxite, fluorspar, flake graphite, vermiculite, beryl, garnet, feldspar, mica, talc (including pyrophyllite), lepidolite, spodumene, barite, ball clay, sagger clay, china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite, thenardite, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, diatomaceous earth, metallurgical grade limestone, chemical grade limestone, and potash, 15 per centum, and

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of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph.

(B) [as added by Sec. 124(c) of the RevenueAct of 1943, c. 63, 58 Stat. 21, and amended by Sec. 207(a) of the Revenue Act of 1950, c. 994, 64 Stat. 906, and Sec. 304(d) of the Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137] *Definition of Gross Income from Property.*— As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or oper-

ators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining) or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of section 450 and 453.

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(26 U.S.C. 1952 ed., Sec. 114.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.23(m)–1 [as amended by T.D. 5413, 1944 Cum. Bull. 124, T.D. 5461, 1945 Cum. Bull. 284, and T.D. 6004, 1953–1 Cum. Bull. 45]. DEPLETION OF MINES, OIL AND GAS WELLS, OTHER NATURAL DEPOSITS, AND TIMBER: DEPRECIATION OF IMPROVEMENTS.—

* * * * *

(f) The term "gross income from the property," as used in sections 114(b)(3) and 114(b)(4)(A) and sections 29.23(m)–1 to 29.23(m)–28, inclusive, means the following:

* * * * *

If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from the property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner

that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method. * * *

U.S. GOVERNMENT PRINTING OFFICE: 1960